BANKING AND CURRENCY

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With an Introduction

BY THE LATE

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PREFACE TO THE EIGHTH EDITION.

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ERNEST SYKES.

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PREFACE TO THE FIRST EDITION.

THIS book is intended mainly as a text-book for students, and it is hoped that it may be of some assistance to those who are reading for the Examinations held under the auspices of the Institute of Bankers, the London Chamber of Commerce, and other examining bodies.

Though the scope and size of the work forbid a detailed handling of many of the subjects treated, an endeavour has been made to give a broadly outlined account of those branches of business and finance with which the banker is chiefly brought into contact.

The Author feels that some apology is due from him for adding to the already long list of works on the subject of banking and

currency, but the excuse is offered that he has found the want of a book which treats, within the dimensions of a single volume and in a manner suitable to the requirements of students, of the kindred subjects which form the title to the present work.

E. S.

LONDON,
November, 1904.

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INTRODUCTION

By F. E. Steele.

THERE is only one school in which the practice of banking can be properly learned, and that school is—a bank. In that school, however, as in others, text-books are required, since in banking, as in most businesses requiring few heads but many hands, the principle of the Division of Labour is very fully exemplified. In a large banking office a man may spend years of his life doing the same thing over and over again in one department, remaining to a great extent in ignorance, so far as regards actual experience—the best of teachers—of the working of the machine as a whole, and its manifold relationship to the complex mechanism of commerce. For even a bowing acquaintance with these, he must, for a time, look mainly to books, the second best teachers, and these, if of the right kind, will assist in filling the inevitable gaps.

Whilst the art of banking is best learned by dint of practical experience—"*à force de forger on*

devient forgeron"—the science of banking, and the laws which govern currency, can, for sheer lack of opportunity, be so learned by only a few, and text-books, desirable as adjuncts in banking practice, become a prime necessity in studying that ground-work of theory on which all sound practice is reared. For instance, thanks to its discoverer and his followers, Gresham's Law, to which Mr. Sykes devotes some of his best pages, is to-day a currency commonplace, but centuries of bungling and of loss on the part of nations elapsed before the knowledge that a debtor will always pay his creditor in the least valuable medium which will be accepted, was carried to its logical issue, made a principle of currency, and recognised in national and international finance. To-day, thanks to earlier thinkers and writers, the novice may learn from a currency text-book what the best heads in Europe failed for centuries to gather from experiment.

Suitable text-books, therefore, must be found, and such a book is this of Mr. Sykes. In the theory of Currency and of Banking he is well versed, whilst in practical banking he has had the best of all forms of banking education; a varied banking experience. *Primâ facie*, we expect him to be instructive, and in this respect the present work fulfils our expectation. But this is not enough. To introduce a book as "instructive" is, in these days, to pronounce its doom. It must do more than instruct; it must interest, if it is to survive; and this book, though necessarily much condensed, will be found to fulfil this further condition. That this should be so is probably due to the fact that the substance of much

of it was first delivered in the form of lectures to City men; and to hold the attention of a hundred or more City men after they (and the lecturer) have gone through a full day of banking, stock-broking, bill-discounting, or what not, is no easy task; it is an impossible one unless, in addition to knowing your subject, you can contrive to make it fairly attractive. Speaking broadly and candidly, only two kinds of purely financial writing can be classed as interesting. The first belongs to a generation now almost past; the generation of Bagehot and of Giffen; the second consists of those parts of the City articles of the daily papers which deal with the stocks and shares we hold, or hope to hold.

Though he would probably not lay claim to the main characteristics of either school, Mr. Sykes contrives to put his points in a manner which invites attention. In dealing with elementary matters of currency, for example, he refers to the shilling as the "degenerate descendant" of the twentieth part of a pound weight of silver, and in discussing financial crises he compares the raising of the rate of interest to the application of the brake to a bicycle descending a steep hill. "A rash use of the brake at the worst part of the hill will probably only precipitate the calamity which it is desired to avoid"—a simile, homely but apt, which carries the writer's shaft home.

The outstanding feature of the book, however, is not this. It is the fact that it brings together, within two covers, information some of which is not to be found in books at all, but of which the greater part would have to be sought in many other books.

If we want information on currency problems, we turn to the works of Jevons, Walker, Nicholson, or Hartley Withers; for the Foreign Exchanges we go to Goschen and Clare; for Banking Law to Paget, Grant, or Hart; for Banking History to Gilbart, Andréadès, and MacLeod; for Banking Practice to Hutchison if we have leisure and means; to Moxon if there is pressure on our time and pocket; and to George Rae if the combination of a colloquial style and a ripe experience appeals to us. In this book of Mr. Sykes' all these subjects are handled; none of them so voluminously, of course, as in the works of some of the writers referred to, but all in a manner which fully suffices to give the reader a clear working idea of their nature and scope. This is the characteristic which will commend the book both to the practical banker and to the student of banking and currency problems.

F. E. STEELE.

BANKING AND CURRENCY.

CHAPTER I.

THE FUNCTIONS AND ATTRIBUTES OF MONEY.

IT has long been the practice in certain quarters to point the finger of scorn at the theorist in banking matters, to taunt him with the old proverbs that "an ounce of practice is worth a peck of theory," and that "a little learning is a dangerous thing." Perhaps this tendency has been less marked of late years, for not only in banking but in nearly every branch of human activity it has been recognised that scientific knowledge is desirable, if not absolutely necessary, and this desire for knowledge has been manifested in the recent development of educational and examining bodies in most professions and businesses.

In spite, however, of this widespread thirst for information, it is wise to remember that the above time-honoured proverbs still contain some truth in

them. Banking certainly is a profession or business, whichever one may prefer to call it, in which the more practical virtues are altogether indispensable. Tact, knowledge of character, a clear head and a cool judgment, combined with that capacity for taking infinite pains which has rather mistakenly been held to be the chief attribute of genius, all these are required to make a successful banker, and without a considerable share of them, no amount of theory will suffice. It is well then to remember that the theory of banking must supplement and not take the place of those business habits which are essential to success. "You cannot make a silk purse out of a sow's ear," and a raw junior clerk cannot fit himself for the management of a bank by two or three months' desultory reading of text books.

Keeping this proviso in mind there is, however, no doubt whatever that a thorough knowledge of the theory of banking is a most useful possession, one with which no bank clerk can afford to dispense. Given equal conditions in other respects, the man in any station of life who does his work intelligently is always superior to the man who obeys instructions blindly. Place these men in a position outside the usual routine to which they have been accustomed, and the difference between them becomes still more apparent. The bank clerk who is content to fulfil merely routine duties may find that a knowledge of banking theory is unnecessary, but to the man who is ambitious to rise to positions of greater responsibility, such knowledge is not only desirable but imperative.

When we approach the subject-matter in hand we are met at the outset by the difficulty of a proper definition. What is meant by "currency"? Such well-known authorities as Sir Robert Peel and Lord Overstone excluded from the term all forms of paper money except bankers' promissory notes payable to bearer on demand, though neither of them had a satisfactory reason for so doing. The fact that a Bank of England note is legal tender seems to have misled many people into drawing a distinction between it and all other forms of paper money, and the word currency is often used therefore to denote that part of the circulating medium which is legal tender. When, however, we come to discuss those monetary problems which have so long vexed the world and for which a satisfactory solution has yet to be found, problems which are intimately connected with the relation between money and prices and the maintenance of a stable standard of value, we shall find that no broad distinctions exist between the various forms of paper money. Not only so, but it will be found convenient for many purposes to group together coin and paper money, and for this reason the term currency is generally used to denote the whole of the circulating medium by means of which debts are paid and prices are measured. It is synonymous with money in its broader sense, and contains the two subdivisions of the coinage and the paper circulation, that is, bills, notes, cheques, postal orders and similar forms of money.

To establish a satisfactory monetary system and to keep that system in a proper condition are tasks which have sorely tried many generations of states-

men and economists. Experience has shown that a debased or depreciated currency is a national evil of the greatest magnitude. The English Statute Book bristles with harsh enactments designed to repress these evils, most of which failed owing to ignorance of the proper principles which should govern a monetary system. In the time of Blackstone counterfeit coining was treason, the most serious crime in English law, while even as late as 1832 the penalty for this crime was death.

The functions of money are three in number. It acts as—

(1) A medium of exchange;
(2) A measure of value;
(3) A standard of value for deferred payments.

To consider the first function; without a medium of exchange mankind would be reduced to the expedient of bartering goods against goods. English history shows abundant traces of this cumbersome form of payment. The manorial system was based upon it. In the Middle Ages money was very scarce in England outside the towns, the villein was in nearly all cases paid for his services in goods, and rent took the form of a proportion of the yield of the land, paid in kind. Needless to say it is far too cumbersome a system for commercial nations, and severe limits were placed upon its use in England by the Truck Act of 1831, which forbade the payment of workmen wholly or in part by goods, a method of payment which had proved capable of great abuses.

Secondly, money acts as a measure of value, and

it is necessary to warn the student against any misconception of the meaning of this latter term.

Value and utility are based upon two very different sets of ideas. Value is not absolute, but always implies a ratio—a relation to another article or articles. The utility of an article on the other hand is simply its power of supplying the wants of mankind, a vague power which cannot be measured. Such terms as "intrinsic value" should be used with extreme caution, or they will cause great confusion of thought.

Value is usually defined as "ratio of exchangeability." Transposed into common language, this means that the value of anything is what it will fetch. Unlike utility, value can be accurately measured and expressed; for instance, the value of gold bullion in relation to silver bullion is, say, 75 to 1, in other words an ounce of gold will buy seventy-five ounces of silver. You can express the value of any article in terms of any other article, but it is obvious that in a very early stage of civilisation mankind would realise the advantage of having some single article by which to measure the value of other articles. If one man measured the value of his vendible commodities in corn, another in beef, and a third in cloth, and so on, endless confusion and dispute would infallibly ensue. This common measure of value is money, and value when expressed in terms of money is called "price." The distinction between value and price should never be overlooked, especially since the terms are somewhat loosely used in ordinary language. The value of gold to silver bullion we stated to be, roughly, 75 to 1;

but the price of silver bullion is, say, 1*s.* 6*d.* an ounce. It is an economic error to speak of the value of wheat as being 30*s.* a quarter; thirty shillings is the expression of the value of a quarter of wheat in terms of money and is therefore its price.

As civilisation advanced beyond its early stages the necessity for the third function of money began to gain in importance. When a settled form of government was gradually evolved and commerce and industry became organised, men entered into contracts to be fulfilled at some future time, and the necessity of a standard of value arose. In arranging a monetary contract the parties to it would naturally wish that it should be fulfilled under the same conditions, so far as possible, as those under which it was entered upon. If a man borrows a thousand pounds to be repaid at the end of twenty years, it will be a serious matter for him if the value of the pound, as regards commodities generally, has risen at the end of the twenty years to three times its original proportions, for in effect he will have to repay three times the amount he borrowed. Money, therefore, since it has to fulfil the function of a standard of value, should be so far as possible stable in value, that is, its value with regard to other articles generally should change as little as possible. Examples of the catastrophic effects of the loss of stability in the value of a currency are not far to seek since the nations of Europe, driven by the stress of the Great War and its consequences, threw overboard the recognised principles of currency regulation.

Bearing in mind these three functions or duties

which money is required to fulfil, we shall be easily able to enumerate and understand those attributes which a perfect system should possess. Jevons (*a*) mentions the following seven qualities as necessary:

(1) Value of material;
(2) Portability;
(3) Indestructibility;
(4) Homogeneity;
(5) Divisibility;
(6) Stability of value;
(7) Cognisability.

Money as a medium of exchange demands the second, third, fourth, fifth and seventh attributes. It must be portable and, so far as possible, indestructible. The material of which it is made must also be homogeneous, that is, any one unit of it must be of the same value as any other unit of the same size and weight. Any substance which differs in value in the mass would be unfit for use as money because of the action of Gresham's law, as we shall see later.

Obviously again the material of which the medium of exchange is to be made must be capable of being divided without losing its value. Precious stones, for instance, possess many of the necessary attributes, but not this one of divisibility. If you cut a diamond into four equal portions, not only does it lose weight in the process, but the four portions are each worth perhaps not an eighth of the original value of the stone. Lastly, the medium of exchange must possess the quality of cognisability; it must be

(*a*) Money and the Mechanism of Exchange, chap. 5.

of some substance easily recognisable as such without expert knowledge, and which cannot readily be counterfeited. None of our money possesses this attribute in perfection, and the counterfeit coiner still carries on his lucrative, if risky, profession, but it is not easy to turn out a counterfeit gold coin which will defy a close examination.

Money as a measure of value must, according to Jevons, possess the first attribute, that is, it must be made of some material which possesses value apart from its use as money. At first sight this may seem undoubtedly true, but a little reflection forces us to modify Jevons's statement. He is quite right in urging that such archaic forms of money as the West African "cowries" did possess some value as ornaments, but it is quite possible that money may be made of a comparatively valueless material and yet possess value as money. Sir John Maundeville, in his highly interesting book of travels, speaks of the Emperor of Tartary as follows: "He spendeth and maketh no money but of imprinted leather or of paper; . . . they make no money either of gold or of silver and therefore he may spend enough and outrageously." Perhaps Sir John is not a sufficiently trustworthy chronicler to be quoted in a book on an economic subject, but we can find other examples nearer home. A banknote is made of paper, the value of which as paper can be disregarded; but in certain circumstances, which we shall examine in a later chapter, the right to demand gold for a note may be, and frequently has been, suspended, and yet the value of the note has remained practically unchanged. Given certain conditions, an inconvertible

paper currency may retain its value with regard to other commodities for an indefinite period, and for this reason Jevons's dictum that value of material is an essential attribute of money must be regarded as inconclusive.

Money, as regards its third function, that of a standard of value, demands more especially the sixth attribute, stability of value; and this attribute, which is possibly the most necessary and important, is certainly the most difficult of attainment. A stable standard of value has hitherto proved an impossibility, and we seem no nearer to it now than at any time in monetary history. All we can do is to accept the best substitute for a perfect material. All civilised nations have in historic times agreed in the choice of gold and silver as the nearest approach to perfection, with copper, bronze and nickel for the coins of smaller denomination. But both gold and silver have varied widely in their value as regards commodities generally; they are neither of them sufficiently portable to meet the requirements of modern conditions, for the cost of transmitting even gold for long distances is a heavy item which is never incurred when it can be well avoided. Neither are they indestructible, as can be easily proved by a cursory examination of any English silver coin dating back for twenty years or more; and lastly, as many know to their cost, they are not always recognisable and are capable of being counterfeited.

CHAPTER II.

THE VALUE OF MONEY.

SINCE price is the expression of value in terms of money, we can measure and record the values of all vendible commodities by means of their prices, but in the case of money we are met with the difficulty that, being itself the measure and standard of value, there is no medium in which to express its price. The value of money is expressed by the general level of the prices of all other commodities. If the reader will bear in mind the fact that value always implies a relation to something else, he will be saved from confusion of thought on this head. The values of all commodities are measured by their relation to money; the higher their price the greater their value. But you cannot have a relation between money and money, and the value of a sovereign therefore is measured by its relation to other commodities; the higher the price of these articles, the *lower* the value of the sovereign. The value of money is expressed by its purchasing power; if prices generally rise, the purchasing power of money has become less, because the same amount of money will buy less than when prices were lower. The value of money and the value of commodities there-

fore vary inversely; they are each the opposing scale in a balance: if one rises the other falls, and *vice versâ*.

Beware of the expression "Mint price of gold." It is an awkward phrase, and one in which the word "price" is very misleading to the unwary. The Mint price of gold is the price paid by the Mint in sovereigns for gold bullion of standard fineness. It is the price of the rough metal in finished coin.

In England the Mint price of gold is by law £3 17*s.* 10½*d.* an ounce, that is to say, an ounce of gold is coined into 3·89 sovereigns, or, in other words, a sovereign weighs 123·27447 grains of standard gold. But in practice gold is no longer coined and no sovereigns are in circulation.

Continuing our simile of the pair of scales, we can easily see that the value of money is affected by two different sets of causes, operating on either of the two scales of the balance; on the one hand we have a set of causes intimately connected with the supply of vendible commodities, on the other hand we have to consider the amount of money and the economies in its use.

As an illustration of what is meant by this, let us take the supposed case of a general all-round cheapening in the processes of production, due to increased knowledge and greater skill in the invention and use of labour-saving appliances. If the amount of money remains the same and the same economies in its use are in force, we shall get an all-round reduction in prices; in other words, the value or purchasing power of money will rise.

Look at the other scale of the balance. Suppose in this case that the cost of production of vendible commodities remains the same, but that the amount of money in circulation is less, due, let us say, to the exhaustion of some of the principal gold fields; assuming again that the economies in the use of money remain unaltered, prices will be affected in the same way. Money, obeying the general law of supply and demand, will rise in value owing to the reduction in supply.

It is the action of this double set of causes which renders so difficult the problem of keeping the value of money stable. As we saw in the last chapter, stability is the essential quality for our standard of value, and any changes are an evil to be avoided. Rising prices may give a stimulus to the prosperity of the producing classes for a time, although this stimulus is partly at the expense of the consuming classes, but prices cannot continually rise, and the inevitable reaction is one of the chief causes of those periods of commercial depression and stagnation which characterise our modern industrialism.

Leaving aside all considerations affecting the supply of goods, we will for the present confine our attention to the value of money as dependent on its supply and use. The general rule is, that this value depends on the quantity of money in circulation together with the economy in its use, or, in other words, the "rapidity of its circulation." The greater the quantity of money in circulation the less will be its value, and the higher will be the level of prices, and conversely.

In the same way the more work that each piece

of money will do the less will be its value and the higher will be the level of prices. In John Stuart Mill's words (*a*), "the amount of goods and of transactions being the same, the value of money is inversely as its quantity multiplied by what is called the rapidity of circulation."

This is the Quantity Theory of Money. In some quarters, especially in the United States, it was usual in the days before the War, to throw cold water on the theory, not as a general proposition, for as such it is self-evident, but upon its value as a guide to action. Under modern conditions, said the critics, there were so many countervailing tendencies at work that the operation of the theory was obscured. An increase in the quantity of money in circulation, by stimulating business, was of itself sufficient to increase the quantity of goods coming to market, and *vice versa*, a contraction in the volume of the currency caused a contraction of the volume of transactions. Since the War, however, the results of the neglect of the principle involved in the Quantity Theory have been so overwhelmingly apparent, and nemesis has so rapidly overtaken the governments which have consistently disregarded it, that the Theory has been firmly re-established.

We shall do well to remember that the quantity of money does not depend absolutely upon the supplies of the precious metals from the mines. By far the larger proportion of the money of most industrial nations consists of paper money, obligations to pay gold or silver either on demand or at a fixed period, whether in the form of notes and other paper promises

(*a*) Mill: Political Economy, bk. iii., chap. 8, § 3.

or obligations to pay, or in bank balances. A very small proportion of these promises is ever liquidated in coin. Over a large part of the commercial world the gold basis of the currency is but a pretence. Even where this is not so, and where the obligation to pay gold is enforceable, the supply of the precious metals is far too small to liquidate the obligations existing at any one moment, and most of them are cancelled by a transfer of indebtedness. The superstructure of credit in such countries is based upon the quantity of the precious metals in circulation, and its quantity is, roughly, proportionate to that of its basis; there is no exact proportion, however, and so the paper circulation possesses the useful attribute of "elasticity."

At certain periods, when trade is more than usually prosperous and transactions are multiplied, the work which the money of a country has to perform is correspondingly greater, and a demand for an increase in the quantity of the currency often occurs; this demand is met by an increase in the superstructure of credit, which, in a proper system, expands and contracts automatically. This power of expansion is called "elasticity," and is, up to a certain point, beneficial, since it tends to steady prices. We shall have occasion to refer further to this when considering the subject of the regulation of notes issues.

CHAPTER III.

GRESHAM'S LAW.

THE monetary history of most civilised nations, up to quite a recent date, is a long record of failures to keep the currency in a proper condition of repair, failures marked by extreme ignorance of the general laws which govern all currency systems, and marred by a long list of severe penal statutes which, in spite of their extreme severity, were generally inoperative. In our own country fresh issues of new coins were from time to time made, only to disappear almost immediately. The coins in circulation were worn, clipped, debased, and of a bewildering multiplicity of design and weight. The weaker portion of the community necessarily suffered greatly, and the less scrupulous found a constant harvest of profit ready at hand.

The most important of these principles, and the one most constantly ignored, is that known as Gresham's law. It is, of course, a scientific law, not a political law. A scientific law is the expres-

sion of a universal tendency which experience has shown to follow certain conditions through the action of a known cause. A political law, or legislative enactment, says that a certain course of events *must* take place; a scientific law states that a certain event *does* occur under stated conditions.

Gresham's law is named after an Elizabethan knight, founder of the Royal Exchange, who is supposed to have inspired a Royal proclamation in which the law is first stated. Although first published as early as Elizabeth's reign, the law was not generally recognised until long after, and this early statement of the law was only one of several aspects in which it can be viewed.

In its earliest and simplest form it is expressed as follows: "*If coins of the same metal, but of varying weight and quality, circulate together at the same nominal value, the worse coins will tend to drive the better from circulation, but the better will never drive out the worse.*"

Legislators could not understand why people should prefer the light coins to those of full weight, and when they issued new full-weight coins they constantly expected them to take the place of the worn coins already in circulation, and were as constantly disappointed. A little reflection will, however, show that the action of the law is quite in accord with the elementary facts of human nature. The essential feature of the coinage is that it is meant to be circulated, to be passed on, and when a man has to part with anything, he naturally parts with the least valuable, provided it will exchange for as much as the more valuable article.

We must remember that until modern banking methods were developed, men saved money by hoarding coins in a chest or the traditional old stocking, and the newest and heaviest coins would be selected for this purpose. Even in these days of scientific knowledge, most men, although they gain nothing by it, have a lurking inclination to keep a brand-new coin, fresh from the Mint, when it comes into their possession. In days when the condition of the coinage left much to be desired, and when the possession of a light coin meant a probable loss to its owner, this tendency was very strong. Again, money changers and others who exported coin or bullion, would have to make good any deficiency in the weight of the coins they exported, for in international transactions currency always goes by weight and not by tale. Therefore, such men would withdraw the heavy coins from circulation. Thirdly, the fraudulently inclined could, with very slight risk of detection and with certain profit to themselves, clip and "sweat" the newer coins so as to reduce them to the general level of those in circulation.

This, then, is the operation of Gresham's law in its simplest form. The heavy coins disappear from circulation, not necessarily from the country. Some are exported or melted down, others are hoarded, and some are fraudulently depreciated in weight; to use a popular phrase, "the bad money drives out the good."

Now let us turn to a currency in which two precious metals are used, and both circulate concurrently at a mutual valuation fixed either per-

manently or from time to time by the State, and we shall find another application of the same law. In such circumstances we shall find that the value of the two metals, which we will take to be gold and silver, towards each other, will at most periods exhibit two distinct ratios.

First, there is the ratio of the market value of the two metals as bullion, which varies within certain narrow limits from day to day, in obedience to the usual market influences which affect all commodities; and secondly, there is the State ratio at which the coins of the two metals are declared current—the "Mint ratio" as it is now called. So long as these ratios, the Mint ratio and the market ratio, remain identical, Gresham's law will be inoperative, but experience has shown that it is a matter of extreme difficulty, if not of impossibility, to keep these ratios for long at the same figure.

Directly a divergence occurs there is a tendency for the coins of the over-rated metal to drive the under-rated from circulation. Take the case of the Japanese currency at the time when that country was first opened up to European influences. At that time coins of gold and silver circulated at a ratio of about 5 to 1, which was approximately the market ratio in that country. The European trader was not long in discovering that he could buy an ounce of gold in Japan for about five ounces of silver and that this same ounce of gold was in Europe worth about fifteen ounces of silver. Of course the Japanese gold coinage rapidly disappeared from circulation.

Take another instance from English history.

When gold was first coined in appreciable quantities in England, in Edward I.'s reign, it constantly disappeared from circulation through being underrated. Gold "florences," or florins were proclaimed current at six silver shillings. But at the market value of the two metals to each other the florin was worth, we will say, seven silver shillings. By melting a gold florin and selling the bullion to a goldsmith seven shillings could be realised, while it would only settle a debt of six shillings at the proclaimed valuation. Consequently people paid their debts in silver, and hoarded, melted or exported the gold, because this was the cheaper method.

We will then formulate this second application of Gresham's law as follows:—*If coins of two precious metals be circulated at a fixed ratio of exchange with one another, the overvalued metal will tend to drive the undervalued from circulation.*

There is a third form of this important principle applying to the relations between a metallic coinage and a paper currency. The excessive issue of paper money has been one of the most frequent causes of monetary confusion in the history of modern nations. So long as the paper money is redeemable in coin or bullion on demand, any excessive issue will soon automatically correct itself, but when in periods of acute financial embarrassment a government is driven to the expedient of issuing an inconvertible paper currency, great self-restraint is necessary to prevent an over-issue. So long as the limit is not exceeded, the limit prescribed by the usual needs of the commercial community, an inconvertible currency can retain its value unless the credit of the

government is unusually bad; but so soon as the issue becomes excessive, gold tends to disappear from circulation and the paper money becomes depreciated in value.

The abnormal increase in the amount of the currency results in a fall in its value and a rise in the price of commodities. Other nations find it cheaper to pay in goods than in gold, and the surplus currency is gradually exported. Needless to say this exported surplus takes the form of coin or bullion, for other nations will not accept paper. The ensuing scarcity of coin encourages hoarding, and the stock of gold coins in circulation rapidly dwindles. If the issue of paper still continues the next result is a divergence between paper prices and gold prices. Gold is said to be at a premium, paper is "depreciated." At this stage paper is obviously the cheaper medium for payment by the debtor, and the remainder of the gold all but entirely disappears.

In a later chapter we shall see the above tendency at work in this country, when the restriction of cash payments at the end of the eighteenth century became the means of thoroughly ventilating the subject. For the present it is sufficient to note the working of the law in its third form: *If an inconvertible paper currency be issued in excess, that is to say, to such an extent that the total amount of the currency becomes greater than the normal amount required by the country, it will tend to drive the precious metals from circulation.*

These are the three applications of Gresham's law. It is perhaps necessary to explain that the

law as originally formulated only covered the first of these phases. But since all three are but modifications of the same idea and are based upon the same general principle, it is expedient to classify them under the same generic title. The application of the law in some one of its phases is constantly claiming the attention of the student of monetary history, and a thorough grasp of its working is very necessary.

CHAPTER IV.

THE ENGLISH COINAGE.

UNTIL the War the English coinage was regulated under what is called the system of Composite Legal Tender. By law it is still so regulated, but the standard gold coin, though it continues to be legal tender, is not in circulation. A particular form of money is said to be legal tender in a country when it must be received if offered in payment of a debt. Money is full or unlimited legal tender if it can be so offered to an unlimited amount. It is limited legal tender if restrictions are imposed upon the debtor's power of compelling its acceptance.

The simplest monetary system is that of a single legal tender, but obviously there are disadvantages which outweigh the benefits conferred by simplicity. If the single metal is a dear one, such as gold, it is difficult to coin pieces of sufficiently small value for everyday retail transactions. If, on the other hand, the single metal chosen is a cheaper one, the cost and inconvenience of transporting large amounts become insufferable. Of course a State can issue coins of two metals and make no proclamations or enactments at all, allowing the coins to circulate at a ratio varying with the market ratio of the metals

of which they are composed, but such a system, or rather want of system, hardly commends itself to modern business men.

If both metals are made unlimited legal tender and the ratio at which they are to circulate is fixed by the State, the operations of Gresham's law in its second form makes it a matter of extreme difficulty to keep both metals in circulation together for any length of time, as we shall see more plainly in the chapter on Bimetallism.

To obviate this difficulty, the English Government in 1816 adopted the compromise which is called the composite legal tender system, and which has been copied more or less closely by nearly all the civilised nations.

Gold is unlimited legal tender in the United Kingdom. Bank of England £1 and 10*s*. notes are legal tender in England, Scotland, and Northern Ireland for any amount; silver is legal tender in amounts not exceeding forty shillings, and bronze not exceeding one shilling. On the outbreak of the European War in August, 1914, Postal Orders and £1 and 10*s*. Currency Notes issued by the Treasury were made legal tender, but as regards Postal Orders this order was rescinded in February, 1915.

In order to overcome the difficulty arising from the operation of Gresham's law, the Act of 1816 enacted that silver, then worth 5*s*. an ounce, should be coined at the rate of 5*s*. 6*d*. an ounce. In other words, there was in future to be only five shillings' worth of silver bullion in five and a half coined shillings. This reduced our silver coins to the rank of "tokens," a token being a coin whose

exchange value is greater than the value of the metal contained in it.

A little consideration will show that this would effectually prevent gold driving silver out of circulation. No one would export or melt silver coins, because they would lose sixpence on every ounce while the market ratio remained at the level at which it then was. Silver was the over-rated metal,—very considerably over-rated. It would tend rapidly to drive gold from circulation; but to prevent this the Government retained in its own hands the right of coining silver, and this power was only to be exercised sufficiently to provide the country with silver coin for small payments. This limitation of its amount effectually prevented silver from driving out gold. There was only sufficient in circulation for the purposes of small change, and in order still more effectually to prevent silver from being used in heavy payments, and also in order to protect creditors from being forced to receive large quantities of token coins which would not circulate at full value outside the kingdom, its tender was limited to forty shillings.

Our bronze coins are also tokens, and they are issued under similar conditions to those just described.

Gold, then, and Bank of England notes, which since 1928 have superseded Currency Notes, and, under certain conditions, were, until September, 1931, payable on demand in gold on presentation at the Bank of England, are the only unlimited legal tender in this country. All other forms of money retain their value because they are legally exchangeable for a fixed

quantity of legal tender. The conditions laid down in the Gold Standard Act, 1925, under which the holders of legal tender notes could demand gold in exchange for the notes, were that such notes must be presented at the Head Office of the Bank of England, and that the Bank should deliver gold bullion at the price of £3 17*s.* 10½*d.* per ounce troy of standard gold (*i.e.* eleven-twelfths fine), but the gold should only be delivered in the form of bars containing approximately 400 ounces troy of fine gold (*i.e.* pure gold). The Bank of England was no longer compelled to pay gold coin in exchange for its notes. When, however, in September, 1931, the British Government was compelled to abandon the gold standard, the Bank of England ceased to be under any obligation to pay gold bullion in exchange for legal tender.

Before the passing of the Gold Standard Act, 1925, any individual could take standard gold bullion to the Mint and, provided the quantity were sufficient, demand sovereigns in exchange at the Mint price of £3 17*s.* 10½*d.* an ounce, free of all charge for coining. Previous to the Coinage Act of 1666 (18 Car. II. c. 5), the Crown made the public pay for this privilege. Not only was there a Mint charge to cover the expense of coining, now usually called "brassage," but the Crown retained a varying proportion of the metal as a toll, called "seigneurage," though this latter term is often used to cover both these charges. The result of such charges was found to be a reluctance on the part of the public to bring bullion to the Mint, and the Crown was often compelled to call in older issues to provide metal for the new ones.

The Royal Mint is now relieved of the obligation to

purchase gold, except gold brought to it by the Bank of England. The Bank is compelled by the terms of its charter to buy all gold offered to it at the fixed price of £3 17*s*. 9*d*. per ounce of standard gold, but it may and does have to pay more in competition with other purchasers.

English gold coins are made of standard gold, which is an "alloy" or mixture of eleven parts pure gold and one part of copper. Standard gold is therefore said to be "eleven-twelfths fine" or twenty-two carats fine, a carat being a goldsmith's term for a twenty-fourth part of an ounce. Most of the continental nations coin gold nine-tenths fine, and it is unfortunate that some international agreement on the subject has so far proved impossible, as this difference in fineness makes it necessary to refine foreign gold brought to the English Mint and *vice versa*.

It should be noticed that the price of gold quoted in the Money Article of the London Press since the abandonment of a gold circulation in this country is the price for fine gold, *i.e.* pure gold, the reason being that market dealings are now almost entirely for export. It has therefore become more convenient to deal in fine gold than in standard gold.

At the Mint price of £3 17*s*. 10½*d*. an ounce, a sovereign should weigh 123·27447 grains troy, but since absolute accuracy in weight was in former times, when the machinery was somewhat primitive, a matter of difficulty, the Mint is allowed a slight deviation called a "remedy," amounting to two-tenths of a grain in each sovereign. There is also a remedy in the fineness of the gold of two parts in a thousand. The remedy in weight is still allowed to the Mint, but with

the perfect machinery now in use, it is capable of working within much narrower limits, and no new sovereign would now be issued varying as much as two-tenths of a grain from the standard weight. Half-sovereigns are of a proportionate weight and with a remedy of three-twentieths of a grain, and two-pound pieces and five-pound pieces have been occasionally coined in strictly limited quantities. Once a year the gold coins (if any have been minted) and the silver coins are tested by a jury selected from freemen of the Goldsmiths' Company. The process is called the "Trial of the Pyx," the "pyx" being the box at the Mint in which specimen coins are deposited for the purpose. The ceremony, for it is now little else, has continued from the days of Henry II., if not earlier, and since the days of James I. has been in the hands of the Goldsmiths' Company.

Sovereigns are legal tender so long as they are not diminished by wear below the weight of 122½ grains, and in the case of half-sovereigns, 61·1250 grains. Any individual to whom a coin weighing less than these respective amounts is tendered, is bound by law to deface it and hand it back to the individual who tenders it, and who has to bear the loss. At one time pocket balances adjusted to detect this difference were widely used; the provision has, however, been almost a dead letter, owing both to the difficulty of detection and to the absence of any penalty in the Act for a breach of this duty.

Until quite recent years, the State always fixed the onus of paying for the wear of the coinage upon the public, but it was unable to keep it in a proper condition of repair. The Bank of England always charged

for light gold tendered to it, and as a consequence other bankers sorted out the heavy coins by means of a weighing machine, and returned the lighter ones into circulation.

Gresham's law of course was in operation, and the gold coinage got into such a bad condition that Jevons estimated, in 1869, that 31½ per cent. of the sovereigns, and 50 per cent. of the half-sovereigns, were below the legal limit in weight. About 1884 the bankers of the kingdom took the matter up, and eventually the Government so far receded from the position it had always maintained, that in 1889 a new Coinage Act was passed, providing for the calling in of pre-Victorian gold coins at the expense of the State. Exception was made in the case of coins which appeared to have been illegally or unfairly tampered with, the evidence of such ill-usage being the loss in weight of more than four grains. Such coins would be bought as bullion, but all other pre-Victorian sovereigns and half-sovereigns were to be exchanged by the Mint, through the Bank of England, at their full nominal value. By a Royal Proclamation, pre-Victorian gold coins were declared to be no longer current after February 28, 1891. In 1891 this Act was extended to all the gold coin in circulation, the evidence of ill-usage being altered to three grains loss in weight.

These two Acts marked the abandonment of the traditional view that the loss by wear of the coinage must be borne by the last holder. Whatever may be the general opinion as to the justness or unjustness of this tradition, it had undoubtedly failed in practice, and the State, by passing these Acts, definitely assumed the responsibility for keeping the gold coinage in

repair. The effect on the currency was excellent, and, so long as gold remained in circulation, there was small cause for discontent at the condition of our gold coins.

The condition of the silver coinage is of course of less importance, because it consists of token coins only, which are not required to circulate outside the kingdom, and which do not in any way owe their value to the value of the metal contained in them. In February, 1920, partly owing to the depreciation of the paper pound and partly to a speculative demand for silver bullion, the price of the latter rose above the Mint price of silver, at one time touching 89½ pence an ounce. This meant that our silver coinage was worth more as bullion than as currency, and there was a danger that it would disappear from circulation. Accordingly a new Silver Coinage Act was passed which increased the alloy in the silver coins to 50 per cent. and a new issue of silver coins has almost replaced the old. This not only effectually removed the danger that the silver coins would be melted, more especially as the price of silver bullion rapidly dropped to its present level of about 1*s*. 9*d*. an ounce, but it also enormously increased the State's profit on the silver coinage.

SCHEDULE to the Coinage Act of 1891.
As amended by the Coinage Act, 1920.

Denomination of Coin.	Standard of Fineness.	Remedy Allowance.		
		Weight per Piece.		Millesimal Fineness.
		Imperial Grains.	Metric Grams.	
GOLD:				
Five-pound	Eleven-twelfths fine gold, one-twelfth alloy; or millesimal fineness 916·6.	1·00	0·06479	2.
Two-pound		0·40	0·02592	
Sovereign		0·20	0·01296	
Half-sovereign		0·15	0·00972	
SILVER:				
Crown	One-half fine silver, one-half alloy; or millesimal fineness, 500.	2·000	0·1296	5.
Double-florin		1·678	0·1087	
Half-crown		1·264	0·0788	
Florin		0·997	0·0646	
Shilling		0·578	0·0375	
Sixpence		0·346	0·0224	
Groat or Fourpence		0·262	0·0170	
Threepence		0·212	0·0138	
Twopence		0·144	0·0093	
Penny		0·087	0·0056	
BRONZE:				
Penny	Mixed metal, copper, tin, and zinc.	2·91666	0·18899	None.
Halfpenny		1·75000	0·11339	
Farthing		0·87500	0·05669	

CHAPTER V.

ENGLAND'S ADOPTION OF THE GOLD STANDARD.

FOR the past century England, in spite of the lapses occasioned by the stress of the War and its consequences, has been unwavering in her allegiance to the gold standard of value. Other nations have changed or hesitated, and but for England's refusal to alter her present system, it is probable that some attempt to create a universal double standard would have been made. In this country there has, it is true, been at times an influential political minority in favour of change; but the banking and commercial classes have been unmistakably in favour of a continuance of the monetary policy which has done so much to build up London's financial reputation.

In these circumstances it is singular to reflect that England adopted the gold standard by a happy accident. The event which marked out England's future path as the upholder of gold monometallism is the rating of the guinea at twenty-one shillings in 1717, and this rating was due to an illogical and partial adoption of Sir Isaac Newton's report, a report which was intended to prevent, and not to hasten, the displacement of silver by gold in our currency.

Originally our standard was a silver one, based

upon the Saxon pound's weight of that metal, and our shilling, which weighs the sixty-sixth part of a pound troy and contains 50 per cent. alloy, is the degenerate descendant of the twentieth part of a pound's weight of silver. Gold has circulated freely in the country since about the beginning of the fourteenth century, but at varying rates compared with silver. Until the beginning of the eighteenth century the bulk of the coinage was of silver, but soon after the great recoinage of silver in 1696 gold began to displace the less valuable metal in circumstances which aroused general alarm. This recoinage of William III.'s reign had been necessitated by the disgraceful condition into which the silver coinage had been allowed to fall, most of the coins in circulation being from 30 to 50 per cent. below their correct weight. This caused the rating of the guinea to vary according to the condition of the silver coins in the locality. Guineas had originally been coined in 1663 to circulate at twenty shillings; but owing to the depreciation in the silver coins their value with regard to the latter rose. The holders of guineas refused to part with them in some cases for less than thirty shillings, "not," as an anonymous pamphleteer remarks, "that gold became worth 30s. a guinea in good money, but in clipped and counterfeit coin."

After the recoinage of the silver at a cost to the nation of £2,700,000 the price of guineas fell to twenty-two shillings; but to the general alarm the new silver which had cost so much to issue, rapidly disappeared and gold poured into the country.

Gresham's law was in operation in its second

form. Gold was over-rated, and therefore was driving silver from circulation. At first sight it seems difficult to see in what manner gold was over-rated, because guineas circulated at a varying rate, and there was apparently no attempt on the part of the Government to fix a ratio between the two metals. How, then, can gold be said to have been over-rated?

The following letter (*a*) issued by the Treasury Board to the Exchequer answers the question:—

"Oct. 25th, 1697.

"Sir,

"The Lords Commissioners of his Majesty's Treasury desire you to signify to the tellers in the receipt of Exchequer, that they receive guineas at 22*s*. each, pursuant to the advertisement in the Gazette of Thursday last.

"(Signed) WM. LOWNDES."

This was tantamount to fixing the price of the guinea at twenty-two shillings, and at this ratio gold was over-rated.

Sir Isaac Newton was asked to give his advice, and his report, issued in 1717, is a piece of thoroughly sound reasoning. He showed that in France, Holland, Italy, Germany, Poland, Denmark, and Sweden, the ratio between gold and silver did not exceed 15 to 1, and that at this ratio the guinea would be worth 20*s*. 8½*d*. in silver. But in England the guinea at this time passed at 21*s*. 6*d*., and it was therefore a profitable proceeding to send

(*a*) S. Dana Horton, The Silver Pound, p. 24.

gold to England and buy silver with it for export to these countries.

Newton's advice was as follows (*a*): "If gold were lowered only to have the same proportion to the silver money in England which it hath to silver in the rest of Europe, there would be no temptation to export silver rather than gold to any other part of Europe. And to compass this last there seems nothing more requisite than to take off about 10*d*. or 12*d*. from the guinea. . . . But if only sixpence were taken off at present, it would diminish the temptation to export or melt down the silver coin, and by the effects would show hereafter better than can appear at present what further reduction would be most convenient for the public."

The report was enthusiastically received, and a Royal proclamation was issued rating the guinea at twenty-one shillings—a reduction of sixpence only. This should have been the first step only according to Newton, a provisional measure; but no further steps were taken, although this reduction was quite inadequate, as events soon proved.

There is nothing to show that the omission to proceed further was deliberate: it was apparently a blunder, and the proclamation which was intended to protect the silver coinage had the effect of sealing its fate as a part of the English standard of value.

From 1717 to 1816 both silver and gold were, by custom, in the absence of any legislation on the subject, legal tender to any amount. The Mint was open to the free coinage of both, and they circulated at a fixed ratio to each other. These, as we shall

(*a*) W. A. Shaw, Writers on Monetary History, p. 198.

see later, are the three essential characteristics of a perfect bimetallic system. Yet what was the condition of affairs in practice? No one brought silver to the Mint to be coined because it was worth more as bullion than it was as money. If a merchant had a remittance of silver bullion from the East it would pay him better to buy gold abroad and take the gold to the Mint than it would to take the silver to the Mint direct. In Europe he could buy as much gold as would make a guinea for twenty silver shillings and eightpence. If he took his silver to the Mint and received it back as coin, it would take twenty-one silver shillings to purchase as much as a gold guinea at the legal rating.

The inevitable consequence was that the amount of silver coin in circulation dwindled rapidly and became insufficient even for the purpose of change. What was left was so worn that in 1774 it became necessary to declare (14 Geo. 3, c. 42) that silver should be legal tender for sums exceeding £25, only by weight and not by tale (*i.e.*, number of coins) at 5*s*. 2*d*. an ounce.

For the first time in English history gold formed not only the bulk of the currency, but also the more popular part of the coinage. Gold supplanted silver against the wishes of the nation, but during the eighteenth century people became accustomed to it and grew to prefer it, so that when in 1816, after the great restriction of cash payments, the coinage had to be reorganised, there was never any question of reinstating silver in its old position. The Act of 1816 simply established on a legal basis what had long been settled in practice. The reduction of the

silver coins to token pieces was designed with two objects in view which were successfully attained—the ensuring of a sufficient supply of silver coins for small change, and the establishment of gold as the bulk of the coinage and the standard of value.

At the same time one innovation was made by this Act which has been an incalculable saving of trouble. Previous to 1816 the standard unit of account in England did not coincide with the standard unit of the coinage. Sums have always been reckoned in pounds, shillings, and pence, the shilling having consistently been the twentieth part of a pound, originally, as we saw before, a twentieth of its weight. But the pound had never been coined before. Occasionally there had been gold coins in circulation which exchanged for twenty shillings, but the rating of the gold coins had previous to 1717 been very variable. For a century people had reckoned in pounds and paid in guineas, and we have a survival of those days in the custom of charging fees in the older professions, in guineas, and of giving subscriptions to charities in the same form. But this double system is very troublesome in dealing with large sums, and accordingly in 1816 the guinea was replaced by a smaller coin, the present sovereign, rated at twenty shillings, thus bringing the unit of the coinage into conformity with the unit of account.

CHAPTER VI.

BIMETALLISM.—I. THE FRENCH SYSTEM.

THOSE whose memories can carry them back for forty years or so will not need to be reminded that the subject of bimetallism was formerly acutely controversial. The average man is prone to regard the subject as one of unfathomable complexity, best left to the expert. A deep study of the subject certainly does lead one into intricate byways, but the main issues at stake are easy to understand.

In the 'eighties and early 'nineties of the last century, when bimetallism was favoured by many as an alternative to the gold standard, conditions were somewhat similar to those which threaten us at the present time. We were then, as we are now, faced with the possibility of a gold famine ; that is to say, the annual production of gold was insufficient to meet the losses due to wear and tear on the one hand, and, on the other, to provide the new gold for monetary purposes necessitated by the growing trade of the world and the extended use of gold as a monetary standard by the more backward nations. The effects of such a famine showed them-

selves in falling prices, and then, as now, falling prices meant business depression and unemployment. In this country there was then no unemployment insurance, and there were no published statistics of the unemployed, but there were unemployment riots in Trafalgar Square and widespread discontent with monetary policy, focussed on the defects of the gold standard.

In these circumstances a determined attempt was made to persuade the people of this country that the scarcity of gold could best be remedied by reinstating silver as a joint standard along with gold, and interest was directed to the experiments which had already been made, more particularly by France, earlier in the century.

The subject divides itself naturally into two periods: the first, the attempt of France, with the aid of some of the other Latin nations, to maintain a bimetallic system in defiance of the resistance of the other commercial nations; the second, following on the failure of the first, the attempt to organise an international bimetallic system by united action on the part of the chief civilised countries of Europe and America.

As explained in the last chapter, the characteristics of a perfect bimetallic system are three in number: concurrent circulation of gold and silver at a ratio fixed by the State; the opening of the mints to the coinage of both metals on equal terms; the

establishment of unlimited legal tender for both metals.

These were the principles adopted by France when she reorganised her currency after the chaotic mismanagement of her "assignats" and "mandats" at the end of the eighteenth century. The law of the 7th Germinal, 1803, embodied this system, the ratio between the two metals being fixed at 15½ to 1. The weakness which eventually proved the ruin of the system was the difficulty of keeping this mint ratio identical with the market ratio of the two metals as bullion. Directly the two ratios began to vary Gresham's law came into operation and the over-rated metal tended to drive the other from circulation. In this way what was in theory a double standard became in practice an *alternating* standard. At one time the preponderating bulk of the coinage was of gold, at another time of silver, but only for very short periods did they circulate together in anything like equal quantities.

This is well shown in the French monetary history of the nineteenth century. Below are given Dr. Soetbeer's (*a*) table of the average market ratio of gold to silver bullion during periods of ten and five years:—

YEAR.	AVERAGE MARKET RATIO.
1811—1820	15·51 to 1
1821—1830	15·80 to 1
1831—1840	15·75 to 1
1841—1850	15·83 to 1
1851—1855	15·41 to 1
1856—1860	15·30 to 1
1861—1865	15·40 to 1

(*a*) Appendix to Final Report of the Gold and Silver Commission, p. 162.

Observe that between 1811 and 1850 the average market ratio was always slightly above the French mint ratio of 15·5 to 1; consequently silver was over-rated in France and drove gold almost entirely from circulation. H. D. Macleod, the author of the "Theory and Practice of Banking," says, "I myself can testify that in 1839 there was not to be seen a gold coin in France in common use" (*a*).

This state of affairs lasted until the gold discoveries of the middle of the century. In 1848, the Californian gold fields were opened, followed in 1851 by similar discoveries in Australia. Most of this gold was alluvial, and therefore easily extracted. The output of the metal was enormously increased. Between 1831 and 1840 the estimated average annual production of gold was £2,830,000; between 1841 and 1850 this average rose to £7,638,000; and between 1851 and 1860 to £27,815,000. Something like a panic occurred in the gold-using countries, owing to the anticipated fall in the purchasing power of gold, due to this sudden increase of the quantity in circulation. History had no parallel on record except the silver discoveries in South America, following the exploitation of that country by the Spaniards in the sixteenth century, and in that case it is generally agreed that two important results ensued: First, a fall in the purchasing power of money as shown by the general rise of prices; and, secondly, owing to the greater increase in the quantity of silver compared to gold, there was a disturbance in the market ratio between the two metals, which rose from about 11 to 1 to about

(*a*) H. D. Macleod, "Bimetalism," 2nd ed., p. 15.

15 to 1 between 1550 and 1650. Extravagant prophecies were made of wholesale ruin to gold-using countries like England, but fortunately events were not so bad as was expected. Both of the phenomena which distinguished the silver discoveries of the sixteenth century were repeated in the nineteenth century, but only to a very small extent.

It is still a contested point whether the rise in general prices which occurred between 1850 and 1860 was due to the gold discoveries, but it is unquestionably true that such a rise did take place. Prices are, however, the result of such a complex set of causes that it is not yet possible to assign with certainty a cause for the rise.

Professor Jevons worked out a table of what are called "index numbers," representing the average yearly price of about fifty of the staple articles of commerce. He took the year 1849 as equalling 100; by 1855 the index number had risen to 125; in 1860 it was 124, and in 1865 121. Several well-known economists have worked out index numbers on separate lines and with very similar results, and there is no room for doubt that the rise in prices did take place. It may reasonably be inferred that this rise was due to the gold discoveries.

As to the second result anticipated, a disturbance in the ratio between the two metals, the table on p. 39 will show that this did occur, but that it was so small as to be apparently insignificant. It was not insignificant because it was sufficient to bring the market ratio below the French Mint ratio of 15½ to 1, and it is to the history of the French currency that we must look for an explanation of

the smallness of the change. This explanation was first given by Michael Chevalier, the well-known French authority on money.

Writing in the *Revue des Deux Mondes*, in 1857, Chevalier pointed out that France had absorbed a large proportion of the new gold. Directly the market ratio fell below 15½ to 1, gold became over-rated in France, and began to displace silver. From 1822 to 1851 France imported every year, without exception, more silver than she exported, the excess of imports often being very large indeed. Between 1852 and 1864 the position was exactly reversed, and her exports of silver invariably exceeded her imports of that metal. Immense quantities of silver were exported from France in the years succeeding the gold discoveries, and its place was taken by the new Californian and Australian gold.

Thus, the French silver was set free for use in other countries, and the surplus gold was absorbed, and this naturally prevented any wide divergence of the ratio from its existing figure.

Gold was being produced at a more rapid rate than silver. France absorbed the gold, and set free her stock of silver. "In this way," says Chevalier, "France serves temporarily as a *parachute* to retard the fall of gold relatively to the other precious metals."

This is called the "*compensatory action of the double standard.*" France had absorbed the metal of which the supply had increased, and had set free the metal which tended to increase in value compared to the other. The rate of production of gold was threatening to become much greater than

formerly; France set up a demand for gold, and, so to speak, compensated for the increase in its supply.

This compensatory action is, however, only possible in certain circumstances, and for a limited period. France was able to absorb the surplus gold because it happened that the bulk of her currency at the time consisted of silver. Directly France became "saturated" with gold the action ceased, and if the increased production of gold had continued, there would in all probability have been a more decided fall in the ratio. But it did not continue. The bulk of the newly-discovered gold was on the surface, the mines were soon exhausted of this easily obtained metal, and the output declined.

Summarising the results of the influence of the French bimetallic system upon the increased gold production, we arrive at the following conclusions:—

(1) It helped to steady the market ratio between the two metals.

(2) To a lesser extent it helped to steady general prices, for the immense quantities of silver exported by France were not re-coined in Europe, but were probably partly exported to the East and partly used in other directions. Thus, the total metallic currency in Europe was reduced, and the rise in prices checked.

(3) Its action was only temporary, and ceased when silver was driven from the ordinary channels of circulation in France.

(4) Although this action was beneficial to Europe generally, it was very expensive to France. She

not only had to bear the inconvenience resulting from a change in the metal forming the practical standard of value, but she had to bear the cost of re-coining almost the whole of her currency. Between 1850 and 1857, France coined gold to the value of over £109,000,000 sterling.

We can hardly wonder then that England saw no valid reason for abandoning her gold standard in favour of the French system. France, indeed, rallied round her some of the other European States, Belgium, Italy, and Switzerland, who, on December 23rd, 1865, signed the monetary treaty called the Latin Union, afterwards joined by Greece. This treaty, according to the views expressed by the French Minister at Washington, "had a sole object, that of putting an end to the disappearance of fractional silver." France and her pupils, when the change in the ratio began to result in the disappearance of their silver, found the want of small change very inconvenient. Accordingly, they resolved to coin their smaller silver coins as tokens, maintaining the full weight and fineness of the five-franc piece. The terms of the Latin Union were:—

(1) That gold coins and five-franc pieces of the fineness of nine-tenths were to be coined to an unlimited extent, to be of the same weight and equally legal tender in any of the countries which became signatories to the treaty.

(2) The smaller silver coins were to be of proportional weight, but only ·835 fine, thus reducing them to the rank of tokens and preventing them leaving the country; such coins to be limited by the population of each country, and to be legal tender

to the amount of fifty francs, only in the country which coined them.

The avowed object of this treaty was to protect the smaller silver coins, but hardly had it been signed when events occurred which once more raised the market ratio above $15\frac{1}{2}$ to 1, and once more threatened to flood the bimetallic countries with silver.

These events were twofold: First, silver was discovered in apparently inexhaustible quantities in Nevada and some of the other Western States of America. Secondly, a violent reaction in favour of gold as a single standard set in all over Europe. At an International Conference held in Paris in 1867, all the delegates, with the single exception of Holland, voted in favour of gold monometallism. Germany, in 1871, followed this up by starting to re-model her coinage, the bulk of which was at the time silver, and the model she adopted was the English system. Thus, we see that an immense increase in the supply of silver occurred almost simultaneously with a startling decrease in the demand for it for coinage purposes. The Latin Union was faced with an inevitable deluge of silver at the expense of the existing gold coinage.

They found the prospect too uninviting. The people had become accustomed to gold, and, like the English people in the preceding century, they were unwilling to abandon it for the more cumbersome silver currency.

Accordingly, in 1874, a meeting of the Union was held, at which it was resolved to close the mints to the free coinage of standard five-franc pieces, and

limit strictly the amount of these to be issued. In theory they still adhered to the double standard ; in practice they had adopted a system hardly to be distinguished from the composite legal tender system. Silver was still legal tender to an unlimited amount, but the amount of silver in circulation was kept within strict bounds. It was a "limping" or "halting" system of bimetallism. The real French bimetallic system had proved a failure.

CHAPTER VII.

BIMETALLISM.—II. INTERNATIONAL ACTION.

WITH the closing of the mints of the Latin Union to the free coinage of silver in 1874, we enter upon the second phase of the bimetallic question. This second phase is quite distinct from the first, which had just ended disastrously, if not ignominiously. Though the object was the same, the maintenance of silver as a co-ordinate standard of value with gold, the motives were different and different means of attaining the desired object were advocated. The position of silver was forced upon the attention of the commercial nations by the impending danger that the rush for gold as a sole standard of value would result in a serious rise in the value of that metal. What had proved impossible of achievement to France and her Latin allies, it was now sought to attain by the united action of the civilised world.

The example of Germany in "demonetising" her silver was copied by several of her northern neighbours. Germany, just emerging into a fresh national life after the Franco-German war, proceeded ener-

getically in the re-modelling of her coinage, and between 1873 and 1879 she threw upon the market more than 7,000,000 lbs. of silver (*a*). Holland and the Scandinavian Governments pursued the same policy, and the United States of America in 1873 ceased the coinage of silver. This serious decrease in the demand for silver, and the increased supplies from the mines and from the "demonetised" silver currencies, soon resulted in a fall in the gold price of that metal. The price of silver bullion had for a couple of centuries or more averaged from 5*s.* to 5*s.* 2*d.* an ounce. In 1873 it dropped to 59¼*d.*; in 1875, 56⅞*d.*; in 1876 in six months it fell from 56⅛*d.* to 48¼*d.*, and has almost without intermission declined until it reached as low as 1*s.* 0*d.* an ounce. Simultaneously with this fall in the gold price of silver, and, for many years, in striking conformity with it, occurred a fall in general prices, dating from about the same year, 1873.

These two phenomena, the fall in the price of silver and in the prices of all commodities, form the groundwork for the bimetallists' attack upon the single gold standard. Put shortly, their argument was as follows: There has been a sudden and unprecedented demand for gold for coinage purposes to take the place of the silver thrown upon the market; the supplies of gold are not only stationary, but actually declining, and the world's stock has proved quite inadequate to meet the demand. Consequently gold has risen or "appreciated" in value, in accordance with the accepted theory that the value of money depends upon the quantity in circu-

(*a*) Shaw, History of Currency, p. 219.

lation and the amount of work that quantity has to perform. This "appreciation" shows itself in a fall in prices, and silver, having become a commodity and being no longer the standard of value, has naturally shared in the fall. The remedy, the only remedy, they said, was to come to some agreement to coin silver again, to circulate at a fixed ratio as legal tender. By so doing the quantity of money in circulation would be increased, and prices would rise again.

Their opponents, the gold monometallists, denied the premises upon which the bimetallists based their arguments. The year 1873 and its immediate predecessors, they said, were years of abnormally high prices, and all arguments based upon these prices were fallacious. The drop which occurred, however regrettable, was only a natural reaction; temporary rises and declines in prices were unfortunately unavoidable, but time would remedy the evil. As to recoining silver as a standard of value, the advocates of the single standard denied the possibility of raising silver to anything like its old price; they might increase the demand for it, but the supply had so grown that a return to the old level was not practicable. The smallest rise in price would stimulate production and cause mines hitherto regarded as unprofitable to be re-opened. Moreover, they regarded silver as a cumbersome and clumsy medium of exchange for large payments, and for this reason deprecated any attempt to open the mints again to its recoinage. As to any international agreement to maintain silver in circulation, a majority of the party frankly denied its possibility and viewed the proposal as quixotic.

In England the drop in the price of silver was regarded with comparative equanimity. England was neither a silver-producing country, nor was she a holder of silver to any extent. It was only in her Eastern possessions, particularly India, that the blow was severely felt. But the decline in general prices was a serious handicap to a commercial nation like ours, and the strength of the bimetallic party in England was mainly the result of its promise that the recoinage of silver would force prices up again.

There is and always has been considerable misunderstanding in the popular mind as to the supposed advantages of rising prices. It must be borne in mind that what we should always strive to maintain is a stable standard of value. *Any* change in the value of money is an evil. It is possible, though not certain, that to a nation like England, with a large foreign trade, a fall in the purchasing power of money, with its attendant rise in prices, is a lesser evil than its converse. For instance, the period between 1860 and 1873 was one of the most prosperous periods in English history, and prices were constantly on the up-grade. But we must remember that the nation was peculiarly able to bear the disadvantages arising from rising prices. It was the period succeeding the adoption of Free Trade, and though the connection is in some quarters denied, yet it must be admitted that our foreign trade increased so fast that a maintenance of the rate of growth could hardly be hoped for. Not only were prices rising, but wages also rose, and the price of foodstuffs, so far from sharing in the

rise, had greatly fallen. Rising prices as a rule mean hardship to the wage-earning classes of the community, a very large proportion of the population, because prices usually rise faster than wages. This hardship was not felt to any great extent in the period preceding 1873, but if the programme of the bimetallic party had been carried out and their avowed object of raising prices been achieved, there is little doubt that it would have caused severe distress in some quarters, for such a rise must necessarily have been sudden.

The loss inflicted on the mercantile community by the fall in prices after 1873 was a real one, for it meant that the anticipated profit of the manufacturer would possibly be turned into an actual loss. Modern manufacturers do not work to order but must anticipate demand, and the margin of profit is so small that it requires but a very small drop in prices to change this profit into a loss. Constantly drooping prices to a large extent paralyse industry, and so react on the whole community. Nevertheless it must be remembered that the loss is incurred during the process of the decline, and that a sudden jump upwards is not the remedy.

The history of the bimetallic movement is a record of abortive international conferences held at the instance of France or the United States, at Paris in 1878 and 1881, and at Brussels in 1892, with the object of rehabilitating silver as a standard of value, and maintaining it in circulation by international agreement. The question was thoroughly ventilated in this country by means of a Select Committee of the House of Commons

appointed in 1876 to inquire into the depreciation in the value of silver, and also by the Royal Commission of 1886, usually called the "Gold and Silver Commission," but although a considerable addition to our information on the subject was gained, no practical result ensued. The failure of the international conferences was undoubtedly chiefly due to the attitude adopted by England. London had acquired a reputation as the central gold market of the world, and the country was firm in its resolve not to jeopardise this reputation by rash experiment. Thus, while the English delegates usually shared in the opinion that silver ought to be maintained in circulation as much as possible, they neither would nor could promise England's active support in establishing a universal recoinage of the metal.

For many years the bimetallic question was the most prominent economic problem before the world, yet about the years 1897–1898 all interest in the matter suddenly dropped. It is perhaps rash to say that bimetallism is dead, but at all events it has totally ceased to be a factor in the political world; if not dead, it is at least dormant. How are we to account for this sudden loss of interest in a subject which only a few years ago divided the world into two hostile camps? The reason is that the chief arguments of the bimetallic party were rendered useless by the subsequent trend of events. The ground had been cut away from their feet and the party had no longer a *raison d'être*.

First of all, the general level of prices, which had almost constantly dropped since 1873, became

stationary about 1895–1897, and then rose steadily, as will be seen by a reference to any of the published index numbers of the price of staple commodities. This cut away one prop of the party. Then the opening up of the South African Goldfields, and the rapid increase in the world's annual output of gold, cut away the other prop.

The bimetallists had argued that gold had appreciated in value owing to the supply being insufficient to meet the increased demand, hence the fall in prices. This insufficiency in the supply was rapidly counteracted by the enormous output of the Transvaal mines, which in 1915 amounted to £38,627,461, and the chief argument in favour of adopting a double standard of value has been invalidated.

Looked at in one way this result was a triumph for the bimetallic party. The more extreme of the monometallists had denied that the increased use of gold had resulted in a scarcity of that metal, but the rise in prices which followed the increase in the gold supply seems a confirmation of the bimetallic argument.

The arguments put forward by the bimetallic party were more logical than those of their opponents, but in England, at all events, it was not a question only of logic. The victory of the gold monometallic party was a victory of strong common sense and the habit founded on long experience over abstract theory unsupported by such experience. Considering the length of the tradition which lay behind the use of gold as a single standard in England, the unique financial position which

London had built up by means of this gold standard, and the generally successful commercial position of the country, it would undoubtedly have been rash on her part to abandon her coinage system in favour of a scheme which, however logical in theory, had as an experiment, though only a limited and partial experiment, been a distinct failure.

But, as was pointed out at the beginning of Chapter VI., we are again face to face with the same difficulties. The Gold Delegation of the League of Nations in the summer of 1930 reported that there was every prospect of a failure of the supplies of new gold to keep pace with the demands for it as a standard of value. It is extremely unlikely that new gold-fields of any extent will again be discovered. Is it possible that international action will again be invoked, not indeed to coin silver, but to use it as part of the reserve held by the central banks of the world against their legal tender issues?

CHAPTER VIII.

CREDIT.—THE REGULATION OF NOTE ISSUES.

WE have hitherto confined our attention to the metallic portion of the currency, and have treated the standard of value as if it were purely a gold standard. But neither in this nor in any other country does the money in circulation consist wholly, or indeed mainly, of gold. In Chapter II. we saw that the value of a country's money depended on the quantity in circulation and the economies in its use. The increasing complexity of modern civilisation and the rapid growth in the volume of monetary transactions have called for the creation of a vast stock of substitutes for gold money, which by economising the use of gold have enabled its production to keep pace with the demand for its use as currency.

These substitutes for coin have the same effect upon the value of the currency as an increase in the coinage. By putting them into circulation the effective power of demanding goods is increased and the value of the unit of currency falls, or, in other words, prices rise.

Hence the importance of maintaining the legal

liability of the issuers of paper currency, whether they be individuals, banks, or Governments, to provide gold whenever it is demanded. So long as this obligation is maintained, both in fact as well as in law, the purchasing power of the currency cannot vary far outside the limits set by the value of gold itself, and as the annual production of gold is small compared with the total stock of the metal, the variations in value due to changes in supply are but small. If an excess of paper currency is issued, prices rise. It will then be found that the gold for which the currency is exchangeable will purchase more goods if spent in other countries and gold will therefore be exported. The result will be that the gold reserves will be depleted and the country will soon be faced with the alternatives of either reducing the volume of its paper currency or abandoning the obligation to maintain the convertibility of the currency into gold.

Where in a country there is a legal obligation to convert the currency into gold on demand and steps are taken to ensure that a stock of gold shall be available for this purpose, the country is said to have a gold standard. England had a gold standard from 1816 to 1914, and in law it continued to possess one throughout the years of the war. The obligation of the Bank of England to pay gold for its notes still existed, and the Currency Notes issued by the Treasury were legally payable in gold on demand at the Bank of England. But the country's stock of gold was mobilised for providing the sinews of war, and the gold reserves of the country were protected by the prohibition of the export of gold

except under licence. The only visible stock of gold was that at the Bank of England, who, with the support of public opinion, put every possible obstacle in the way of those desiring to withdraw gold. The results of our departure from the paths of financial rectitude were minimised by the refusal of the Government to proceed further upon the slippery path of inflation, that is, the creation of credit and currency without regard to its effect in raising prices. Instances of the contrary policy, however, abound all round us. By the passing of the Gold Standard Act, 1925, the gold standard, for a few years, was restored to this country in fact as well as in name, though, as described in Chapter IV., gold coin could no longer be demanded in exchange for legal tender notes, but only gold bars.

The instruments of credit referred to above, by which the metallic currency is supplemented, may take various forms, the principal of which are cheques and other forms of orders to a bank to pay money, and notes, either in the form of bank notes or Government notes. In most European countries it is the habit to keep spare cash chiefly in the form of notes, in English-speaking countries chiefly in the form of bank balances capable of being turned into cheques at the will of the owner. Both are alike in that an increase in their quantity will, other things being equal, be followed by an increase in prices. In England the War was financed largely by an increase in the volume of bank balances. The increase in the volume of the note circulation followed the increase in bank balances and was a necessary corollary, without which the banks would have been unable to meet their obligations. Since

the necessities of the Government added enormously to the total obligations of the banks to the public to pay legal tender on demand, the Government, in the absence of gold, was compelled to provide an adequate stock of legal tender.

In the financial history of this country it has always been considered an axiom by the powers that be that the creation of credit by means of bank deposits can be trusted to look after itself, or, to be more exact, can be left to the discretion and experience of its bankers, but that the creation of credit by means of bank notes should be carefully controlled and restricted by the State. The reason for this distinction is not easy to discover, except in so far as it may apply to notes which are legal tender. It is easy to see why the State should safeguard the issue of notes which it compels creditors to accept in payment of a debt, but the restriction upon the issue of notes in this country has applied to all issues, whether legal tender or not. Possibly the reason for the distinction is that it is comparatively easy to regulate the issue of bank notes but less so the creation of bank deposits. Whatever the reason may be, we cannot now shut our eyes to the fact that an abuse of the creation of credit by either of these methods is capable of producing equally disastrous results.

The result of this policy of strict control applied to the issue of notes is that in almost all countries the issue of notes has become centralised either in the hands of the Government itself or, more usually, in the hands of a Central Bank more or less under Government control. In England the issue of

notes by banks other than the Bank of England ceased to exist in 1921. In Scotland and Ireland the right still exists, though severely restricted. In the other countries of Europe it is generally of little importance.

In all systems of note issue, whether by local banks, by central banks, or by Governments, the most essential feature has hitherto been the maintenance of convertibility into standard coin. This is universally recognised, though the reason is often misunderstood. With an issue of notes such as that of the Bank of England or the Treasury, the necessity for testing the convertibility of the issue seldom arises. When abnormal circumstances occur, such as the outbreak of a great war, which point to the probability of a widespread demand for gold by the holders of notes, the legal convertibility of the notes is usually suspended. The reason for maintaining convertibility is not therefore to ensure that the notes may be redeemed in coin, it is that the maintenance of convertibility is the most efficacious method of insuring against an over-issue. If the country banker knows that he must face the possibility of being called upon to redeem his notes on demand, prudence will insist that the total issued shall be proportionate to his resources in coin. If a Government knows that an over-issue of notes will drive gold out of the country, they must choose between restricting the volume of the notes, or abandoning convertibility. An issue of inconvertible paper may retain its value and perform all the functions of money so long as its amount is restricted, but experience has shown that the power of issuing an

inconvertible paper currency can rarely be exercised in moderation for any length of time, and that the temptation to abuse the power of issue is so great as to be almost irresistible. Particularly is this so in the case of the Government of a modern democratic State, which is always subject to severe pressure from those elements of the population which desire social reforms at the expense of the State without counting their cost.

Ever since the passing of the Bank Charter Act in 1844 the orthodox method of regulating a note issue in this country has been to fix an amount called the fiduciary issue, an amount which is the outcome of previous experience. Against this fiduciary issue, securities may be held, but no gold or other metallic cover is required. All notes issued beyond the limit of the fiduciary issue must be covered by the deposit of gold to an equal amount. This system is described at greater length in the chapter dealing with the Bank Charter Act.

Both the French and the German systems require a reserve bearing a definite proportion to the liabilities of the issuing bank. In France, the Bank of France has a monopoly of the note issue, and since 1928 the Bank must maintain a minimum reserve, in gold bullion or gold coin, of 35 per cent. of the total of its notes plus current account balances. The pre-war provisions fixing a maximum circulation have been abolished. It has the option of cashing its notes at its Head Office either in legal tender gold coin or in gold bullion.

In Germany, the Reichsbank, until the end of the year 1935, shared the right of note issue with four

other banks, but since then it has had a monopoly. The notes of the Reichsbank, convertible into gold at the option of the Bank, must be covered by 40 per cent. gold or " devisen," of which not less than three-quarters must be gold. " Devisen " are defined as " banknotes, or bills of exchange having not more than 14 days to run, cheques and claims due from day to day payable in foreign currency by a bank of known solvency in foreign financial centres " (*a*). Under certain conditions the cover may be reduced on payment of a tax on the deficiency of from 3 to 8 per cent. per annum. These provisions for a deficiency tax were, however, suspended in October, 1933, and the Reichsbank allowed to let its metallic reserve fall below the legal minimum.

The American system is upon a different basis. Until the passing of the Federal Reserve Act of 1913, the United States circulation, exclusive of the gold and silver Treasury Certificates which represent gold and silver deposited in the Treasury to their full nominal amount, consisted, on the one hand, of the United States Government legal tender notes,—" greenbacks," originally issued during the American Civil War, and a small amount of Treasury Notes circulating under the Act of 1890,—and, on the other, of the notes of the National Banks.

The issue of " greenbacks " had for many years been fixed in amount, so that the interest in the United States system, considered as a system, centred round the National Bank circulation. The characteristic of that system was that it was " bond-

(*a*) Kisch and Elkin, Central Banks, 4th Edition, p. 290.

secured"; it was based upon the national debt of the country. Each National Bank had to purchase and deposit in the United States Treasury bonds of the United States Government of a nominal amount equal to the amount of its authorised issue of notes. The consequence was that the volume of the circulation of notes was governed to a large extent by the price of the bonds and failed to respond to the ever-varying demands of the country's commerce. It was rigid and inflexible, and this rigidity was accentuated by the banking law which compelled each National Bank to keep a reserve of coin and legal tender notes (the notes of the National Banks are not legal tender) equal at all times to at least 25 per cent. of its total deposits if the bank is situated in one of certain specified large towns, or 15 per cent. if situated elsewhere. If therefore at any time an exceptional demand for money occurred, not only was it found impossible to meet this demand by a further issue of bank notes, but the demand must be met by encroaching upon the reserves held against the deposits. This necessitated a calling in of bank loans and a general restriction of credit.

In England the defects of a rigid note circulation are not easily realised because the demand for notes is singularly constant. But in the United States the moving of the crops each autumn calls for an enormous addition to the currency which cannot, owing to geographical conditions, be met by the use of cheques, and at this season the want of an elastic note circulation is acutely felt. Conversely, at those seasons of the year when the demand for notes is smallest, the existence of a large surplus stock which

cannot find employment, but which the banks are constantly endeavouring to press into circulation, is a standing menace to the financial well-being of the country.

The Federal Reserve Act of 1913 established Federal Reserve Banks, not less than eight nor more than twelve in all, in the principal towns of the United States, under the control of a Federal Reserve Board. This Board is authorised to issue at its discretion, to the Federal Reserve Banks, notes which are an obligation of the United States Government, and must be covered by the deposit of an equal amount of promissory notes and bills acceptable for discount. Against such notes each Federal Reserve Bank must hold at least 40 per cent. in gold, but in order to give the required elasticity, the gold reserve may be reduced below the minimum on payment of a graduated tax, a provision copied from the German system. The right of the National Banks to issue bond-secured notes is not affected by the Act, except in so far as provision is made for the voluntary retiring of such notes during the period of twenty years after two years from the passing of the Act, by sale of the bonds to Federal Reserve Banks, who are empowered to issue notes to the par value of such bonds purchased. This provision seems to point to an intention to transfer eventually the right of issuing notes from the National Banks to the Federal Reserve Banks.

In England the Committee on Currency and Foreign Exchanges which sat under the chairmanship of Lord Cunliffe after the end of the war, recommended a return to the traditional system of this country, *i.e.* the system of a fixed fiduciary issue. Other

suggestions were considered by the Committee but rejected. One was that all limits on the total of the fiduciary circulation should be removed provided a fixed percentage of the total issue should be held in gold. In the Committee's opinion this system is liable to bring about very violent disturbances. "Suppose, for example, that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one." Another suggestion was that the German pre-war system should be adopted and that an absolute limit to the fiduciary issue should be fixed, provided that the limit might be exceeded on payment of a tax to the Government. This further suggestion was condemned on the ground that if such a tax were to act as a deterrent, it must be sufficiently high to secure that no profit should accrue to the Bank as the result of the emergency issue, and that there were no data before them from which they could fix such a rate. The Committee added that they were not clear how the arrangements recently adopted by the United States, which had not yet been tested by experience, would actually operate. The provisions which were eventually incorporated in the Currency and Bank Notes Act, 1928, are briefly described on pp. 83, 84.

CHAPTER IX.

THE RESTRICTION OF CASH PAYMENTS BY THE BANK OF ENGLAND.

ENGLAND has, before the present time, twice tasted the sweets and bitters of an inconvertible paper currency, once during the Napoleonic wars, and again, in a veiled form, during the period which commenced in 1914 and ended in 1925.

The years preceding the opening of the nineteenth century were one of the most critical periods in our history. England was at the head of the European confederation against revolutionary France, and she had to provide the greater part of the funds for carrying on the struggle. Pitt's constant remittances abroad to subsidise the lesser powers formed a standing menace to the financial well-being of the country. A demand for gold can take either of two forms. It may be a domestic demand, to fill up the gaps caused by a temporary failure of credit. In such a case a great strain is thrown upon the Bank of England; when other paper is discredited the country

has always been willing to accept the notes of the Bank of England, and has learnt to rely upon the Bank's assistance in cases of necessity. The Bank has accepted the responsibility, and has found by experience that the best means of allaying the public fears is to lend freely and generously.

The other form of a demand for gold is a foreign demand, that is to say, a demand for export purposes. In this case the traditional policy of the Bank (*a*) is to restrict her issues of notes and her loans by raising her discount rate, which attracts foreign gold to this country and so stays the drain.

In 1797 a demand for gold occurred from both these quarters. Pitt had repealed the clause in the charter of the Bank of England forbidding it to lend to the Government beyond the amount of its capital, and was drawing freely on the Bank, which was compelled to honour his drafts, although it lent under protest. Then rumours of a French landing in the North of England led to a panic in Newcastle, which quickly spread to London. The Bank directors were at their wits' end. On the one hand policy dictated the free lending of money in order to steady the public nerves and assuage the panic; but, on the other hand, Pitt's borrowings had so tied their hands, and reduced their stock of gold to such a low ebb, that this policy was impossible. On February 25th, 1797, therefore, as the only resource in these difficult circumstances, an Order in Council

(*a*) The word "Bank," when spelt with a capital letter, is used here and in the following pages to denote the Bank of England.

was issued directing the Bank to suspend payments in cash except under certain strict conditions, and an Act of Indemnity was quickly passed. This Act was only to be in force until June of the same year, and no better proof of the temporary nature of the Act can be found than the fact that Bank notes were not made legal tender, and no penalties were enacted for the refusal to receive them. As a matter of fact, the Act was not finally repealed until the lapse of twenty-two years.

The country took the suspension well. The Bank, being freed from anxiety as to its gold reserve, was enabled to lend freely, and confidence was soon restored. A Committee of the House of Commons examined the books of the Bank and reported it perfectly solvent, and it was authorised to issue £1 and £2 notes to take the place of guineas in small payments.

For a time the condition of the currency appeared quite normal, and no inconvenience seems to have been felt from the suspension. About 1801, however, two phenomena began to attract attention: first, a rise of the market price of gold bullion considerably above the Mint price; secondly, an unusual and continued depression in the foreign exchanges.

The market price of gold rose in 1801 to £4 5*s.* per ounce, the Mint price being as now, £3 17*s.* 10½*d.* This meant that people were willing to pay £4 5*s.* for an ounce of gold bullion which, when taken to the Mint, would only yield £3 17*s.* 10½*d.* in coin.

The exchange with Hamburg, then the chief

centre of exchange with England, fell to 14 per cent. below par.

We shall consider the foreign exchanges in a later chapter; suffice it to say now that this meant that if an Englishman owed a debt in Hamburg, it cost him about 14 per cent. more to pay the debt than it would in the case of a debt of the same amount payable in London. But the cost of shipping gold to Hamburg, the most expensive way of settling the debt, was only 7 per cent.; how was the other 7 per cent. to be accounted for? An explanation was given in what is usually called Lord King's law, though Lord King was not the first to see the truth of it. This law is: If a metallic and a paper currency circulate together, and the market price of bullion rise appreciably above the Mint price, accompanied by a fall in the foreign exchanges below the "bullion point," that is, a fall which is greater than the cost of transmitting bullion, this difference between the Mint and the market prices of bullion represents the measure of the depreciation of the paper currency.

It was obviously absurd that people should be willing to buy gold bullion for coin at the rate of £4 5*s.* an ounce, when they could only get it coined at the rate of £3 17*s.* 10½*d.* The fact is, the price of gold bullion was a *paper* price. A debt payable in Hamburg cost more to settle than one payable in London, because the former would have to be settled in coin or bullion, for the paper would not go abroad, while the latter would be settled in bank notes. The conclusion to be drawn was that these bank notes were depreciated, their purchasing

power was less than gold of the same denomination.

This conclusion was at the time strenuously denied. It was pointed out that the notes were not legal tender, and, therefore, although they were temporarily inconvertible, no one was compelled to take them. The Act of 1797 provided that payment in bank notes was to be deemed payment in gold only if offered and accepted as such. The notes circulated freely, without compulsion, and perfect confidence was expressed and felt in the Bank of England on all hands. How then could the notes be depreciated?

The refusal to admit the depreciation was due to the failure to realise that the value of money depends, other things being equal, on the quantity in circulation. Notes were at a discount because they had been issued in excess. An excessive issue of an inconvertible paper currency, however good may be the reputation of the issuing bank or government, and however complete may be the public confidence in its stability, is bound to result in a depreciation of the value or purchasing power of such a currency. The suspension of cash payments had first of all encouraged the hoarding of coin. Gold paid into the Bank of England could only be withdrawn in part, and it was inevitable that the holders of gold should quietly put it by. The gaps caused in the circulation were filled by an increase in the note circulation. Further increases resulted in a surplus of the currency, and part of it was driven abroad. This part was the gold and silver coinage, for foreigners would of course not accept inconvertible paper. When the

bulk of the gold had disappeared from the ordinary channels of circulation, any further increase in the issue of notes would result in a depreciation of the currency, which had by now become practically all paper, and prices quoted would of course be paper prices. Between 1803 and 1809, the depreciation almost disappeared and the market price of gold was seldom above £4; but in 1809 and 1810 the evil became more pronounced than ever, and in the latter year the House of Commons appointed a "Committee to consider the high price of bullion." The report of this Committee, always called the Bullion Report, is of the utmost value as a study of the conditions governing an inconvertible currency.

The report first of all states five incontrovertible propositions:

(1) That the Mint price of gold was £3 17*s.* 10½*d.* an ounce.

(2) That the market price at the beginning of 1810 was between £4 10*s.* and £4 12*s.* an ounce.

(3) That the Exchanges on Hamburg and Amsterdam were depressed from 16 to 20 per cent. below par.

(4) That the issues of the Bank of England and the country banks had considerably increased in amount.

(5) That gold had been driven from circulation, though not from the country altogether.

Having stated these propositions, which were admitted on all hands, the committee reported the conclusions which they drew from these facts:

(1) That the variations of the metallic exchange with foreign countries could never, for any consider-

able time exceed the expense of transporting and insuring the precious metals from one country to another.

The value of a sovereign estimated in Flemish coin was about 34½ Flemish shillings. That was the value of the metals in the respective coins reckoned at the current price of silver, and is called the "par of exchange" between the two places, London and Hamburg. It is obvious that a debt payable in London may be worth slightly less in Hamburg, because it will have to be collected or liquidated in some way, and the proceeds remitted to Hamburg. This causes variations in the rate of exchange, but the Bullion Committee urged that such variations could not be more than the cost of settling the debt by remitting coin by sea.

Estimating this cost at 7 per cent. at the utmost, or 2½ Flemish shillings on each £1 sterling, the latter would be worth not less than 32 shillings. But at the rate quoted on the Exchange, a debt of £1 sterling due in London was selling for 29 Flemish shillings only in Hamburg.

As an explanation of this, the Committee lays down as the second of their conclusions:

(2) That this difference of about 9 per cent. or more which could not be accounted for, was due to the excessive issues of inconvertible paper by the Bank of England. A debt due in London would be paid in this paper as a matter of course. If the debtor wished to pay in gold, he would have to buy gold, and £1 in paper was worth considerably less than £1 in gold.

The third conclusion was;

(3) That the market price of gold bullion could never exceed the Mint price to any appreciable extent, unless the currency in which the bullion was paid for, and in terms of which it was quoted, was depreciated below the value of full weight coins.

To all who have grasped the meaning of the term "Mint price of gold," this is obvious. The bullion may be quoted in terms of depreciated paper, as in this instance, or it may be quoted in terms of coins worn below their proper weight, but unless the currency be depreciated in some way, the difference cannot exist.

The fourth conclusion was the logical result of the third:

(4) That therefore the difference between the market price of gold and the Mint price exactly measured the depreciation of the Bank of England notes.

The report continues: "Your Committee beg leave to report it to the House as their most clear opinion that, so long as the suspension of cash payments is permitted to subsist, the price of gold bullion and the general course of exchange with foreign countries, taken for any considerable period of time, form the best general criterion from which any inference can be drawn, as to the sufficiency or excess of paper currency in circulation; and that the Bank of England cannot safely regulate the amount of its issues, without having reference to the criterion presented by these two circumstances."

Finally, they strongly advised an immediate return to cash payments. "Upon a general view of the subject, your Committee are of opinion that no safe,

certain, and constantly adequate provision against an excess of paper currency, either occasional or permanent, can be found, except in the convertibility of all such paper into specie . . . Your Committee therefore cannot but see reason to regret that the suspension of cash payments, which, in the most favourable light in which it can be viewed, was only a temporary measure, has been continued so long."

Moderate and clearly expressed as were the opinions of the Committee, the House refused to adopt them, for the question had become a party one, the peace party against the war party, and a series of resolutions, denying the truth of the conclusions drawn by the Committee, was passed by a large majority.

But time soon gave the advocates of the Bullion Report their revenge, and clearly vindicated the correctness of their views. In 1813, Napoleon was overwhelmed at Leipzig and peace was declared. Violent speculation followed, ending in commercial disaster. In two years, eighty-nine country banks failed, and hundreds tottered on the verge of ruin, and their notes were discredited. The Restriction Act of 1797 had not applied to the country banks, but these had been able to pay their obligations in Bank notes, and had consequently greatly increased their circulation. What the circulation of country notes amounted to we have no means of ascertaining, for no official returns were then made, but the total was undoubtedly large, and the failures of 1814 of course resulted in a sudden decrease in the total amount of the note circulation of the country. The

Bullion Report stated the cause of the high price of gold bullion and the adverse condition of the exchanges to be an excess of paper. The diminution of the amount of the paper currency in 1814 should therefore have resulted in a fall in the price of gold bullion, and this is exactly what happened. In October, 1816, the market price of gold was £3 18*s*. 6*d*. an ounce, and the exchanges with Hamburg and Paris rose above par.

The Bank of England therefore began to resume the payment of its notes in gold. The first attempt was a failure owing to a sudden drain of gold to France caused by the attempts of that country to place its currency on a sounder basis, but in 1819 the resumption was successfully carried out.

CHAPTER X.

THE BANK CHARTER ACT OF 1844.

THE report of the Bullion Committee contained a clear explanation of the proper method of regulating an inconvertible paper currency. The Bank Charter Act of 1844 governs and restricts the issue of bank notes convertible into gold on demand.

For some years preceding the passing of this Act, the condition of the note issues of this country had caused very general dissatisfaction in financial circles. Commercial crises had occurred at frequent periodic intervals, involving the failure of numerous country banks, and gravely imperilling the ability of the Bank of England to meet its engagements. These crises were in many quarters attributed to the excessive issue of notes both by the Bank of England and, more especially, by the country bankers. Gradually two hostile theories were evolved, each of which was claimed by its supporters to be the only method of governing a note issue. These two theories were the Currency Theory and the Banking Theory. The Currency Theory is this: In issuing

bank notes, care should be taken that the amount in circulation should always be the same as the amount of gold would be, provided the notes did not exist. Mr. S. J. Loyd, better known as Lord Overstone, was the chief exponent of these views, and the following is his opinion as expressed in his evidence before a Select Committee of the House of Commons on the note issue of the country in 1840:—

"A metallic currency I conceive, by virtue of its own intrinsic value, will regulate itself; but a paper currency, having no intrinsic value, requires to be subjected to some artificial regulation respecting its amount. The use of paper currency is resorted to on account of its greater economy and convenience, but it is important that that paper currency should be made to conform to what a metallic currency would be, and especially that it should be kept of the same value with the metallic currency, by being kept at all times of the same amount. Now the influx and efflux of bullion is the only sure test of what would have been the variations of a metallic currency, and therefore I conceive that that constitutes the only proper rule by which to regulate the fluctuations of a paper currency."

Their opponents, the upholders of the Banking Theory, urged, on the other hand, that the only consideration a banker need bear in mind in regulating his issues of notes was whether these issues were made in legitimate banking transactions, as opposed to speculative dealings outside the ordinary commercial channels. If the amount

of notes issued in this legitimate manner should be greater than that needed by the country, the excess would inevitably be presented for payment. Mr. J. W. Gilbart, the general manager of the London and Westminster Bank, was one of the chief exponents of this view, and he ridiculed the idea that a country banker should regulate his issues by the movements of gold to and from the country. The country circulation, he said, increased or decreased according to local conditions, the state of the harvest, and of local trade.

The names "Currency Theory" and "Banking Theory" have by now been forgotten, but the two schools of thought in currency matters still subsist. On the one hand, there is the orthodox school which teaches that the surest guide to the regulation of the amount of the paper circulation, whether it be in the shape of notes or cheques, is afforded by the movements of gold to and from the country. On the other hand, we still have the insurgent school which regards the connection between gold and the volume of currency as a fetter, crippling trade expansion, and a barrier to progress.

The Bank Charter Act was a victory for the upholders of the Currency Theory, and its main provisions were as follows:

(1) (*a*) The Bank of England was to be divided into two Departments, the Issue Department and the Banking Department, to be kept wholly distinct from each other.

(*a*) The numbers here given to the sections are not the numbers of the clauses of the Act.

(2) Securities to the value of £14,000,000 were to be transferred to the Issue Department, and notes were to be issued to this amount and transferred to the Banking Department. All coin and bullion not required for immediate use was to be deposited in the Issue Department, and all notes issued beyond the sum of £14,000,000 were to be secured by the presence in the Issue Department of gold and silver to an equal amount with that of such excess issue.

(3) The silver bullion held in the Issue Department was never to exceed a fourth part of the gold coin and bullion.

(4) Any one might demand notes from the Issue Department in exchange for gold bullion at the rate of £3 17*s.* 9*d.* per ounce.

(5) If any country bank should, after the passing of the Act, cease issuing notes, the Bank of England might be authorised by her Majesty in Council to increase the amount of the securities in the Issue Department to the extent of two-thirds of such lapsed issue, and to issue notes against such securities.

(6) An account of the notes issued, the securities and gold and silver coin and bullion in the Issue Department, the capital stock and deposits, the money and securities in the Banking Department was to be published weekly in the London Gazette.

(7) No stamp duty was to be payable on Bank of England notes.

(8) The Bank was to pay £180,000 a year for its privileges and exemption from stamp duty.

(9) All profits on the issue of notes beyond £14,000,000 were to go to the public.

(10) No person other than a banker was in future to issue notes payable to bearer on demand in the United Kingdom.

(11) After the passing of the Act no bankers were to issue notes payable to bearer on demand except such bankers as on May 6th, 1844, were issuing their own notes.

(12) If any such banker should become bankrupt or should from any cause cease to issue notes, he was not to resume such issues.

(13) Every banker claiming the right to issue notes was to send to the Commissioners of Stamps a return of the average amount of such issues for the twelve weeks preceding April 27th, 1844, and no banker should in future exceed on an average of four weeks the amount of this average of twelve weeks.

(14) If the monthly average should ever exceed this fixed amount, the bank should forfeit an amount equal to such excess.

(15) Every bank of issue should in future send a weekly account of its issues to the Commissioners of Stamps, which was to be published in the London Gazette.

(16) All bankers were to send their names once a year to the Stamp Office.

(17) All bankers were in future to have the right of drawing, accepting, or endorsing any bills of exchange not payable to bearer on demand.

First of all it must be noted that the action of the Issue Department is quite mechanical. If gold is offered, the Bank must buy it, and must issue notes against such gold, which notes, if not required for circulation by the public, are kept in the Banking Department. Every note issued by the Bank must be represented by an equal amount of gold in the Issue Department, with the important exception that £14,000,000 in notes may be issued against securities. This latter amount, called the "fiduciary issue," has, in accordance with paragraph (5), been periodically increased until it now stands at £260,000,000. The second point to notice is that the Act aimed at the strict limitation and gradual extinction of the issues of the country banks, and by so doing it has conferred a monopoly of issuing bank notes upon the Bank of England. Paragraphs (11), (12), and (13) have resulted in the extinction of the country circulation. The number of banks which in 1844 retained the right of issuing notes in England and Wales was 279, with an authorised issue of £8,631,647, that being their average actual circulation for the twelve weeks preceding the date named in the Act. The last of these issues lapsed in 1921 with the amalgamation of the business of Messrs. Fox, Fowler & Co. with Lloyds Bank Limited.

The working of the Bank Charter Act during the

period between 1844 and 1914 is well described in the following passages taken from the Interim Report of the Cunliffe Committee on Currency and Foreign Exchanges published at the end of the year 1918.

"Since the passing of the Act of 1844 there has been a great development of the cheque system. The essence of that system is that purchasing power is largely in the form of bank deposits operated upon by cheque, legal tender money being required only for the purpose of the reserves held by the banks against those deposits and for actual public circulation in connection with the payment of wages and retail transactions. The provisions of the Act of 1844 as applied to that system have operated both to correct unfavourable exchanges and to check undue expansions of credit.

"When the exchanges were favourable, gold flowed freely into this country and an increase of legal tender money accompanied the development of trade. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold. The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking reserve, with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process was repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here

which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream.

"If the adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure above described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the position of London as the financial centre of the world. But the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty.

"When apart from a foreign drain of gold, credit at home threatened to become unduly expanded, the old currency system tended to restrain the expansion

and to prevent the consequent rise in domestic prices which ultimately causes such a drain. The expansion of credit, by forcing up prices, involves an increased demand for legal tender currency both from the banks in order to maintain their normal proportion of cash to liabilities and from the general public for the payment of wages and for retail transactions. In this case also the demand for such currency fell upon the reserve of the Bank of England, and the Bank was thereupon obliged to raise its rate of discount in order to prevent the fall in the proportion of that reserve to its liabilities. The same chain of consequences as we have just described followed and speculative trade activity was similarly restrained. There was therefore an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general. Domestic prices were automatically regulated so as to prevent excessive imports; and the creation of banking credit was so controlled that banking could be safely permitted a freedom from State interference which would not have been possible under a less rigid currency system."

The Bank Charter Act of 1844 has been modified in important respects since the War. As we have already seen, the Gold Standard Act, 1925, relieved the Bank of the liability to pay its notes in gold coin, giving the holder in its place the right to demand gold bullion in bars of approximately 400 ounces (see p. 25).

The Currency and Bank Notes Act, 1928, transferred to the Bank the privilege of issuing £1 and 10*s*. notes

hitherto exercised by H.M. Treasury, at the same time raising the amount of its fiduciary issue from the pre-war figure of £19,750,000 to £260,000,000, and giving greater elasticity to the note circulation by granting to the Treasury the right, on application by the Bank, to permit a temporary increase in the total of the fiduciary issue. It also conferred upon the Bank the right to purchase gold coin or bullion held by any person in the United Kingdom if it amounted to £10,000 in value, other than gold held for immediate export or required for industrial purposes. The permission given by the 1844 Act to retain in the Issue Department silver bullion not exceeding one-fourth of the value of the gold coin and bullion was repealed, but the Bank was allowed to include, among the securities held against the fiduciary issue, silver coin not exceeding £5,500,000 in amount.

CHAPTER XI.

THE DEVELOPMENT OF BANKING IN ENGLAND.

BANKING in the modern sense of the term can be said to have originated in England in the foundation of the Bank of England in 1694. Previously to this the goldsmiths had exercised some of the functions of a banker, and the oldest existing private bank, that of Messrs. Hoare, is the direct descendant of one of these goldsmiths. At the time of the Great Rebellion men had found it convenient to lodge their money for security with the goldsmiths, who for the purposes of their own trade usually possessed ample accommodation for storing plate and jewellery. The depositors received a receipt, and when they wished to withdraw a portion of the money, the amount so withdrawn was often written across the face of the receipt. These receipts were the parents of the bank note, the transition from an acknowledgment of money received to a promise to pay, being an easy one. But the development of banking on a large scale had been hindered by the instability of public credit. Before the Revolution of 1689, public credit had depended upon the good faith of

the individual monarch, and both Charles I. and Charles II. had shown how little reliance was to be placed on this by confiscating for their own purposes money lodged by the public in the Exchequer. The accession of William III. introduced the system of parliamentary responsibility and parliamentary control over the national finances, and when once confidence was established in the integrity of the State, a system of credit based upon mutual confidence between man and man became possible. Without absolute good faith in monetary matters on the part of the State, a proper system of banking cannot be developed; hence the importance of the foundation of the Bank of England. Bishop Burnet writing at the time said: "I had heard the Dutch often reckon up the great advantages they had from their banks, and they concluded that as long as England continued jealous of the Government, a bank could never be settled among us, nor gain credit enough to support itself; and upon that, they judged that the superiority in trade must still lie on their side."

The Bank of England is, needless to say, not a State Bank; it is a corporation with exceptional privileges, which owes its inception and career to its position as Government creditor and Government banker.

The Bank was not established, as might be supposed, with the idea of developing English commerce by the creation of a powerful bank; it was simply an expedient for gaining money for William III.'s continental wars against Louis XIV. The Bank was founded to lend the Government the amount

of its capital in return for certain privileges. The idea was suggested by a Scotchman named Paterson and taken up by Montagu, the Chancellor of the Exchequer, with immediate success, the capital of £1,200,000 being at once subscribed. The whole of this amount was lent to the State at 8 per cent. per annum, to which was added £4,000 a year for the expenses of management. The Bank was empowered to issue notes to the same amount, £1,200,000, but not beyond.

The success of the Bank of England, which was a Whig scheme, induced the Tories to try a similar experiment, and they introduced and passed a measure for establishing a land bank. The scheme was a total failure, but to prevent its recurrence the Whigs in 1708 passed an Act which forbade any other bank consisting of more than six persons, to "borrow, owe, or take up any sum or sums of money on their bills or notes, payable at demand, or at a less time than six months from the borrowing thereof."

This Act had a very great influence on the development of banking in this country. It did not forbid the establishment of joint stock or corporate banks, but it forbade such banks to issue notes, and such was the importance attached to this function that no attempt was made for a century or more to found any serious rival to the Bank of England. It established the predominance of the latter, and this predominance has been the factor which has coloured the whole of the history of banking in this country. No restrictions whatever were placed upon small private bankers, and as a consequence the type

of country bank in England was much less powerful and less reputable than it otherwise would have been. In Scotland and Ireland, where no such monopoly existed, a group of more or less equally powerful banks was evolved much earlier than has been the case in England. In the past, the English system has undoubtedly compared unfavourably with that which has long prevailed in Scotland, a result due in great measure to the influence of the Act of 1708 and similar enactments confirming it from time to time. During the eighteenth century this influence was especially noticeable, and notwithstanding many honourable exceptions which have survived to the present day, widespread ruin and distress resulted from the frequent convulsions which involved whole groups of country banks.

English banking during the eighteenth century developed in three directions:

First, the Bank of England, owing to the prestige derived from its position as the banker and agent of the State, constantly increased in influence and reputation as compared with the private banks, and gradually assumed an attitude of responsibility for the financial well-being of the country. No legal responsibility of this kind was attached to its position, but owing to the vast discrepancy between its resources and those of the majority of the private banks, men grew to regard the Bank of England as the pivot of the banking system, and to look to the Bank for such assistance as it could afford in times of stress; and the Bank did not disavow this responsibility. The issue of notes was regarded as the principal function of the Bank, but at first these

were not issued for small amounts, and it was not until 1759 that £15 and £10 notes were circulated, while £5 notes were not issued until 1793.

The second line of development was by the private country bankers. The notes of the Bank of England did not circulate to any great extent out of London, for the first branches of the Bank of England were not opened until 1826. The country banks, however, issued notes for quite small sums which circulated locally. In 1775 it was found necessary to forbid the issue of such notes for less than £1, and in the next year the limit was raised to £5. These measures were necessitated by the number of small tradesmen who added the business of banking to their other occupations, and issued notes for insignificant amounts. The consequences of the measure have been felt to the present day, for notwithstanding the temporary revival of £1 and £2 notes during the restriction of cash payments, and in spite of several later attempts at a revival of small notes, England remained, until August, 1914, almost the only commercial country without a circulation of notes below a sum equal to £5.

The third development of banking was that of the London private banks. These banks at first issued notes like the other bankers; in fact, the London goldsmiths' cash notes were the earliest form of such paper money in England. But they soon found that the competition of the Bank of England was too strong, and long before the end of the eighteenth century their issues entirely ceased. In place of this function they developed the system of deposit banking, and the London bankers were the first to

issue printed books of cheques, to take the place of the informal letters by means of which payments or transfers were at first made.

At the time of the resumption of cash payments in 1819, we have then these three groups of banks: the Bank of England, the only joint stock bank in the country, placed by its monopoly in a unique position as regards other banks; the country banks, limited to six partners, and almost entirely unregulated and unrestricted by the legislature; and the private bankers of London, most of them old established firms with good reputations, but whose note issues had entirely lapsed.

In 1825 occurred a serious financial crisis, and the weakness of the country banks aroused widespread comment. Almost for the first time the public began to realise the ill-effects of the monopoly of the Bank of England, and measures were at once brought forward to alleviate the evil.

First, the Bank of England was advised and authorised to open branches in some of the principal provincial towns, and to issue notes from these branches, the towns first selected being Gloucester, Manchester, and Swansea.

Secondly, the issue of notes under £5 was forbidden to the Bank of England as well as the country banks.

Thirdly, an important modification of the monopoly hitherto enjoyed by the Bank of England was effected by the Act of 1826, allowing the establishment of joint stock banks with the privilege of note issues, provided they had no banking office in London or within a radius of sixty-five miles of

London, and that they did not issue their notes at any place within such a radius. The larger towns outside the circle of sixty-five miles gradually availed themselves of this permission, and many of the country joint stock banks which survived until recent years, date from about this period.

Seven years later, in 1833, a clause was inserted in the Bank Charter Act of that year authorising the establishment of joint stock banks in London, provided they did not issue notes payable to bearer on demand. It will be remembered that the Act of 1708 and its complements had conferred upon the Bank of England the exclusive privilege of carrying on the business of banking with more than six partners, and had further defined this privilege as the right to issue notes to bearer on demand or at less than six months date. Doubt had been expressed in some quarters whether the Acts prevented a joint stock bank being established to carry on the business of a banker exclusive of the issue of notes, and this clause in the Act of 1833 was designed to decide the question. The immediate result was the foundation of the London and Westminster Bank in 1834, followed shortly after by the London Joint Stock Bank, the Union Bank of London, and the London and County Bank. The Act of 1833 further declared Bank of England notes to be legal tender in England and Wales for all sums above £5, except by the Bank itself and its branches.

It is not easy nowadays to realise the position of the early joint stock banks. At the present time many of them overshadow the Bank of England itself in the amount of their deposits and the

magnitude of their transactions. But at the time they were founded they were outcasts, regarded as intruders both by the Bank of England and the private bankers, and without even any corporate legal existence, except as a partnership of all the shareholders, necessitating the enumeration of all the names of the shareholders in the smallest legal action brought by the bank. Moreover, they were inexperienced, and found a difficulty in obtaining on their directorate or managing staff, men who had a sufficiently thorough knowledge of the business of banking.

It is therefore not surprising that the business of the early joint stock banks was at first often carried on in a manner which left much to be desired, but notwithstanding their mistakes, it is largely due to them that we owe the development which especially characterises English banking. Deposit banking, with its great facilities for economising capital, has developed to a greater extent in England than in any other country, and this is to a large extent due to the fact that the London joint stock banks have been forbidden to issue notes, and have therefore exerted all their energies in fostering deposit banking, and that therefore cheques have to a large extent superseded notes in circulation. The early joint stock banks were all unlimited as regards the liability of the partners or shareholders for the debts of the bank. The shareholders of those country joint stock banks which were founded under the Act of 1826 were expressly declared to be liable in full for the debts of the company, while those established in London under the Act of 1833, being common law partnerships, were necessarily unlimited.

It has long been an established doctrine in English law that the partners of any trading or business firm are all personally and individually liable for the debts of the firm of which they are members. The doctrine was complete and far-reaching. If, after taking all the private property of the majority of the partners, the debts of the firm were still unsettled, and perhaps one partner remained solvent, he could be compelled to pay the whole of the remaining outstanding debts, if possessed of sufficient private means.

This was equitable enough in the case of private firms where each of the partners takes a personal share in the conduct of the business, but when joint stock companies came into prominence, the law regarded all the holders of shares as partners, and the doctrine of unlimited liability pressed rather hard on shareholders who had practically no control over the business policy of the company. In 1855, therefore, an Act was passed allowing trading companies under certain conditions to register themselves as limited liability companies, the shareholders being liable to the extent of their nominal holdings of shares, but no further.

Banks were, however, excluded from this privilege; it was thought that bankers were in such a responsible position, and were debtors to the public in such large amounts, that it was unwise to afford them any protection in this respect. Two years later, in 1857, a severe monetary crisis resulted in the failure of several banks, notably the Western Bank of Scotland. It was found that the wealthier classes declined to incur the risk of holding bank

shares, and that a large proportion of the shareholders of defaulting banks were not possessed of sufficient means to contribute towards the debts of the company. In order, therefore, to attract a more substantial class of shareholders, it was found desirable, in 1858, to extend the privilege of limited liability to such banks as cared to register under the Act. An exception was, however, made of the liability of shareholders for the note issues of those banks which circulated notes, and the shareholders of banks registered under the Companies Acts which possess a note issue are still fully liable for the amount of such issues.

Most of the large joint stock banks, however, held aloof, fearing that the limitation of the shareholders' liabilities would alarm the depositors in the banks, and result in a loss of business. But the collapse of the City of Glasgow Bank in 1878, and the complete ruin of most of the shareholders, caused such a panic among those who held shares in joint stock banks, that most of the banks were induced to register themselves as "limited." A new Act was passed in 1879, which created what was called "reserved liability." Under the terms of this Act, limited companies could increase the nominal amount of their shares, with a condition that a certain proportion of such nominal increase should not be called up except in the event of the liquidation of the company, this uncallable proportion of the share capital being termed "reserved liability."

The effect of this provision was that while the shareholders of the companies were partly protected, in that the amount they could be called upon to pay

in the event of liquidation was a definite ascertained sum, yet the depositors and other creditors of the bank felt that they had a reasonable security for the payment of the debts due to them.

Judging the English banks by the nature of their constitution, we have five classes, as follows:

(1) The Bank of England is incorporated by Act of Parliament (the only bank carrying on business entirely in England which is so incorporated), and is outside the application of the Companies Acts. It has a capital of £14,553,000 in stock, and the liability of the stockholders is limited to the amount of their individual holding of stock. Thus, although the Bank of England is not registered under the Companies Acts, it possesses the same privilege as regards liability.

(2) There are a few joint stock banks registered under the Companies Acts, but without limited liability, the shareholders being fully responsible for all the debts of the company. The only banks so registered are a few which are by courtesy regarded as private banks, the shares being held privately, and the banks being registered as companies for private reasons.

(3) There is the great body of joint stock banks registered with limited liability, most of whom have declared part of their share capital to be "reserved liability."

(4) There are a few survivors of the once numerous class of private bankers, the number of whose partners must not exceed ten, and whose liability is, of course, unlimited.

(5) Lastly: Certain overseas banks, with head offices in London, have been incorporated by Royal Charter.

The liability of the shareholders is regulated by the terms of the charter, in several instances being fixed at twice the nominal amount of the shares.

In the more recent development of English banking, two tendencies are very marked, the tendency towards concentration by means of amalgamation and purchase, and the spread of branch banking. According to Mr. Jas. Dick's calculations, as given in papers read before the Institute of Bankers (*a*), there were, in 1883, 317 banks in England and Wales, having 2,382 offices, being one office to every 11,315 head of population. In 1891 the number of banks had decreased to 261 with 3,231 offices, or one to every 8,915 inhabitants. In 1901 the figures were 172 banks with 4,872 offices, or one office to every 6,676 inhabitants. In 1911 the number of bankers had further declined to 99, while the offices numbered 6,413, or one to every 5,630 of the population. By 1921 the number of banks, excluding the London offices of the foreign, colonial, and other overseas banks, but including the London branches of the Scottish banks, was only 40, with approximately 8022 offices, or one to every 4722 of the population.

These figures are a striking testimony to the tendency towards concentration combined with expansion. A large part of this opening of new offices has resulted in the creation of entirely new business. Towns which twenty years ago supported two banks now have four, and yet each of the four may have as much or more business than the two

(*a*) Journal of the Institute of Bankers, Vol. xiii., p. 320.

formerly had, although the increase in population may be insignificant.

New resources have been tapped; the "habit of banking," as it is called, has spread. Sixty years ago cheques for small amounts, say under £5, were almost unknown, and none but the wealthy enjoyed the facilities offered by a bank. Now the members of almost every class above the artizan class keep banking accounts, and even the poorest avail themselves of the Post Office and other savings' banks.

All this tends towards national efficiency. Instead of keeping money lying idle in old stockings or cash boxes, it is deposited in a bank and is eventually used in productive enterprise. It helps to cheapen capital, and England owes no small part of her wealth and position to the fact that cheap loanable capital has in the past been so abundant.

The process of concentration by amalgamation is part of a universal tendency. In every department of commercial activity we find this concentration of capital in a few controlling hands. In banking it was almost inevitable. It is not an unmixed blessing; the passing of the local banker to make room for the bank manager means a loss to the community which we are sometimes forced to regret, but on the whole the change has been conducive to greater economy, and, in many cases, we must add, to greater efficiency.

The amalgamations of the last fifty years can be divided into three main classes:

(1) The absorption of private country banks by joint stock banks,

(2) The absorption of the smaller London banks by the larger provincial banks.

(3) The amalgamations between the joint stock banks.

(1) Many of the existing joint stock banks now in the forefront owe their position almost entirely to this first process of amalgamation, by which country banks have been swallowed. Some of our leading joint stock banks have developed without any great recourse to this method of expansion, as, for instance, the London and Westminster Bank and the London and County Bank, until their amalgamation with each other in 1909. But such banks as Barclays Bank and Lloyds Bank have attained to their present size quite recently and very rapidly owing to the number and importance of the banks they have absorbed. We are tempted to inquire, why have the London banks thought fit to buy or otherwise absorb these provincial banks? And why have the provincial banks sold their businesses?

If we look back to the years 1892–96 we shall find our answer to the first question. These years were times of extraordinary "cheap money," that is to say, the rates at which money could be lent and borrowed were abnormally low.

The banker who has a purely London business, that is to say, a City banker, without suburban or country branches, is much more dependent than the country banker upon the ruling rate of interest in the money market. Lending rates in the country are much more stable and less sensitive to market influences than those in the city. In the country the element of risk is greater, the security offered is

not usually so good and the bills discounted are not usually "first-class" bills; these reasons are sufficient to account for the higher rate of interest prevailing.

The result was that while the London bankers found it difficult to maintain their accustomed rate of profit, the country banks and those London banks with a country connection suffered much less severely. This, then, is one reason why the London bankers found it advantageous to obtain a country connection; they obtained a wider basis for their business and equalised their earning rates over a period of years.

The private country bankers accepted the offer made to them not necessarily as a sign of weakness, but because they saw a greater future before them. Most private bankers, relying, in the absence of published accounts, upon their local reputation, found it naturally difficult to extend their business beyond the circle of their personal influence. In many cases, too, want of capital was an obstacle to expansion. But the joint stock banks hoped to develop and expand an old-established local business more quickly than the private banker, and therefore offered the latter terms which it was difficult to refuse.

(2) The second class of amalgamations is that between the larger provincial banks and the smaller London bankers.

Many of the leading joint stock banks have risen into prominence in this way: For instance, Parr's Bank was a purely provincial bank at one time, with a head office in Warrington, until, in 1891, it swallowed the house of Fuller, Banbury & Co., of Lombard Street, and afterwards amalgamated with the Alliance Bank and the Consolidated Bank.

The Metropolitan Bank, which was merged with the London City and Midland Bank in 1914, was the result of an amalgamation between the Birmingham Banking Company and the Royal Exchange Bank. The Birmingham and Midland Bank joined with the Central Bank of London, in 1890, to form the London and Midland Bank, which afterwards united with the City Bank to form the London City and Midland Bank. Most of the small London banks thus absorbed had seats at the Clearing House, and this was no doubt the principal inducement to the provincial banks. Admittance to the Clearing House is a privilege not easy to obtain, and yet without it a bank cannot easily rise to first-class rank.

Even without this entrance to the Clearing House, a London office is an undoubted advantage. London, as is so often insisted, is the financial centre of the world, and not only every English bank but nearly all foreign banks find it necessary to be represented there either by an office of their own or by a London agent. It is this London agent with which many of the more important provincial banks were able to dispense. Since they must be represented in London, it was found at the same time more convenient and more economical to be represented directly by an office of their own.

(3) The third phase of development in the process of amalgamation is that of the large joint stock banks among themselves, including also the amalgamations between the large joint stock banks and the leading private bankers of London.

This process, which has now approached completion, has resulted in the reduction of the number of banks carrying on business in England to about a dozen, excluding the overseas banks and a few quite small

local banks. It is a process which has been hastened, if not rendered inevitable, by the concentration in industry which has characterised recent years. The small banks found that they could not handle the financial operations demanded by the size of their larger customers. The big banks attracted all the big business, both because they could handle it without inconvenience, and because they were able to offer the larger customers the exceptional facilities afforded by a network of branches covering the whole country. The smaller banks were forced to amalgamate or to see the cream of their business attracted to their larger rivals.

Fears have sometimes been expressed that this tendency to concentration may lead to monopoly and that the public may suffer. It is of course rash to prophesy, but there is nothing in recent events to justify this fear. What combination there has yet been between banks has been for the public good. Greater uniformity of practice now prevails than was once the case, and this had led to sounder methods of banking, and so to greater security. Even more important than this, the evolution of a comparatively small number of powerful banks leads to the attainment of that decisive and concerted action in times of emergency and grave financial peril which the delicacy of our mechanism of credit renders a necessity to the national well-being. The events of the Baring crisis in 1890 are an early example, confirmed and strengthened by the course of events during the graver crisis occurring on the outbreak of the European War in 1914, which will be examined in a later chapter.

CHAPTER XII.

CLEARING HOUSES.

WHEN we consider what an overwhelming proportion of the monetary payments in this country are made by means of cheques and bills, it becomes evident that the presentation and payment of these documents is a task of no small difficulty. Obviously it has long been impossible to present them at the counter of the bank upon which they are drawn, and demand coin and notes. The proportion of cheques so presented is insignificant; the remainder are paid, directly or indirectly, by means of one of the Clearing Houses, chief among which of course is the London Clearing House in Post Office Court, Lombard Street.

The exact origin of this institution is uncertain. Gilbart in his "Principles and Practice of Banking," says it was founded in 1775, but we find references to a clearing house in London before that date. It is clear that it had a small beginning and was probably at first a voluntary and informal meeting of clerks sent out to collect cheques drawn upon each others' banks. Some of the London bankers

for a time held aloof, but it eventually became rather an exclusive body, slow to admit fresh members. The early joint stock banks were refused membership, and it was not until 1854 that they obtained admittance.

In 1858 the Country Clearing was established. Before that date country cheques were presented directly through the post and a draft on a clearing banker sent in return, but since 1858 the cheques have passed through the Clearing House by means of the clearing agent, of whom every country banker now makes use.

Four years previous to this, in 1854, a great improvement in the mechanism of the House was effected. The differences between the various members of the House had hitherto been paid in Bank of England notes and coin, but since 1854 each member of the Clearing House has had to keep an account with the Bank of England, and the differences are now paid by transfers between such accounts.

The business of the London Clearing is divided into three sections, according to the geographical position of the bank or branch bank on which the cheque to be cleared is drawn. The Town Clearing comprises cheques drawn on and bills of exchange accepted payable at the head offices and branches of the clearing banks situated within an easy walking distance of the Bank of England—that is to say, within an area somewhat smaller than that of the City of London, and including part of Southwark. The Metropolitan Clearing embraces cheques drawn upon the branches of the clearing banks and

a few non-clearing banks situated in the district outside of the area of the Town Clearing, but within a district roughly corresponding with the London Postal District. The Country Cheque Clearing consists of cheques drawn upon all banks and branch banks in England and Wales outside the area of the Metropolitan Clearing which have appointed one of the London clearing banks as clearing agent—that is to say, practically every bank and branch bank in England and Wales outside the Metropolitan Clearing district. Cheques are usually printed with the letter T, M, or C on the bottom left-hand corner, to indicate the division of the clearing to which it belongs and so to facilitate sorting.

Let us see how the work of the Town Clearing is carried out. Each clearing bank sends round to the Clearing House at the times fixed for the clearing, bundles of "articles" called "charges," each "charge" consisting of cheques drawn upon and bills domiciled with another member of the House. These are exchanged, entered, and added by means of automatic machines, and so far as possible the totals are verified. The "charges" received by each bank are then taken round to the bank and examined and paid. There are two Town Clearings during the day. The morning clearing, commencing on ordinary days at 10.30 a.m., consists chiefly of drafts on the clearing banks which have been received from the branches and country correspondents of each clearing bank by the morning post, together with a certain number of drafts received on the previous afternoon too late for that day's clearing.

The afternoon clearing is the busiest of the

day. The cheques cleared are those drawn upon members of the Clearing House which have been paid in by customers of other clearing banks during the same day, or have been remitted by such suburban banks or West End banks as are in a position to send a midday remittance to their clearing agent. During the afternoon, fresh "charges" are continually being brought to the House right up to its close at ten minutes to four.

As soon as all the charges are entered and agreed the work of settlement commences. First of all the clearing clerk of each bank strikes a balance between the amounts of his in-clearing and his out-clearing with each other bank. The result is the amount which on the day's working he owes to that other bank, or, as the case may be, the amount which that other bank owes to him.

It must not be supposed that each bank then settles the amount owing to or from each other bank by direct payment. The method pursued is much simpler and more economical than this.

Each bank takes its "summary sheet," which has a column of the names of all the clearing bankers with a column on each side for the amounts owing to or from these banks. These two columns are added up, and the difference between the two represents the total sum owing to or by the bank in question, "on general balance." Each bank keeps an account at the Bank of England, and there is also an account called the Clearing Bankers' Account, and the differences are settled by transfers between these accounts. If the X.

Bank owes £7,215 on general balance, it authorises the Bank of England to transfer this amount from the account of the X. Bank to that of the Clearing Bankers' Account. If, on the other hand, the day's work ends in a balance of £745 owing to the X. Bank, it hands to the Bank of England a request signed by an official of the X. Bank and by a Clearing House inspector, to transfer £745 from the Clearing Bankers' Account to the credit of the X. Bank.

We have hitherto supposed that all cheques presented through the clearing have been paid, but there are usually a number of cheques unpaid, either through want of funds or because of some irregularity in the drawing or endorsement; "returns," as they are called.

All returns must in the case of the Town Clearing be received back at the Clearing House by 5 o'clock on the day of presentation, though this hour is slightly extended on certain days when the work is especially heavy. They must bear a written answer upon them stating the reason of non-payment.

When returns are received at the Clearing House they are treated just as if they were cheques drawn upon the bank by which they were presented, and are entered at the end of the summary sheet before the general balance is struck.

The Metropolitan Clearing, inaugurated in February, 1907, opens at 9 o'clock (8.45 on Saturday), and all charges must be received at the Clearing House by 10.30 a.m. (9.50 on Saturday). Each bank receives from the others the cheques drawn

on those of its branches included in the Metropolitan Clearing, the cheques drawn on the other banks being received by their clearing agents. After being entered at the Clearing House they are taken to the Head Office, sorted, and dispatched to the branches by messengers. They are there paid; any cheques not paid must be returned on the day of presentation by post direct to the crossing bank or branch, a slip being sent to the Head Office or clearing agent. Unpaid bills must be returned direct by post on the day of presentation to the Head Office or clearing agent, the crossing bank or branch being notified. The totals are included in the Town Clearing of the next day.

Since the initial difficulties inseparable from an experimental system have been overcome, the Metropolitan Clearing has been a decided success; it has met with general approval, and its sphere of operations has already been considerably extended.

The Country Cheque Clearing opens at 10.30 a.m. (Saturday 10 o'clock), and all drafts must reach the Clearing House by 12.30 p.m. (Saturday 11.5 a.m.). The cheques are delivered and exchanged according to the clearing agent of the bank upon which each is drawn, irrespective of the name of the latter. Each clearing bank therefore obtains a mass of miscellaneous cheques drawn upon its various country branches and correspondents. They are taken to the Head Office, sorted according to the bank upon which each is drawn, and dispatched by the evening post for payment.

Each country banker must, by return of post on

the day of receipt, advise its London agents of the amount of the cheques received and paid, enumerating the returns deducted, if any. Each cheque presented through the clearing must bear across its face the name of the presenting bank, and in the Country Clearing the name of the London agent also, and, according to the rules of the House, it is the duty of "any country bank not intending to pay a cheque sent to it for collection, to return it direct to the country or *branch bank*, if any, whose name and address is across it." Such returns must in every case be dispatched on the same day on which they are received.

Each bank fills up a summary sheet corresponding to that used in the Town Clearing, and containing a list of the balances due to or from each other clearing bank, and the general balance ascertained from this sheet is included in the Town Summary sheet of the next day but one.

In the case of the Town and Metropolitan Clearings, it may be mentioned, bills and various orders to pay which are not cheques are presented through the Clearing House; but in the Country Clearing, bills, promissory notes, and cheques with documents attached are not received, and must be presented through other channels.

The following banks are members of the London Clearing House:—

Bank of England.
Barclays Bank Limited.
Coutts & Co.
District Bank Limited.
Glyn, Mills and Company.
Lloyds Bank Limited.
Martins Bank Limited.

Midland Bank Limited.
National Bank Limited.
National Provincial Bank Limited.
Westminster Bank Limited.
Williams Deacon's Bank Limited.

Besides this, several of the more important City branches of the above banks clear direct without the intervention of their head office.

The admission of the District Bank to the House in January, 1936, brought the last of the independent domestic banks of any size into the Clearing House.

The Bank of England "clears on one side only"; that is to say, it presents through the Clearing House cheques which are drawn on other members of the House, but it requires the other members to present direct to the Bank of England cheques drawn upon itself.

The total amounts cleared are very large and amounted in 1935 to the sum of £37,559,751,000, the highest total on record being that of £44,896,677,000 in the year 1929. Certain days are always busier than usual, and on some of these days some extension of hours is allowed. Such days are the 1st of January, April, July, and October, on which many dividends are payable, and Stock Exchange settling days.

The London Bankers' Clearing House is by far the most important of the English clearing houses. There are, however, local houses at several of the more important provincial towns, notably Manchester, Liverpool, Birmingham, Bradford, Bristol, Hull, Leicester, Leeds, Newcastle, Nottingham, and Sheffield. These, however, are not in any way rivals of the central Clearing House. They are used for the

collection of purely local cheques, which in smaller towns would not be sent to London for collection, but presented directly over the counter of the local banks, and be paid by a draft on a London clearing banker. Instead of this in the towns above mentioned, these local cheques and cheques drawn upon banks situated within a limited radius, are presented through the local clearing house, usually conducted on a similar plan to the London House, and the balances are in most cases transferred through the local branch of the Bank of England. Cheques drawn upon banks in towns other than those within the specified radius are, however, collected through the London Clearing House in the usual way.

Although our system of clearing cheques is complete and far-reaching as regards each of the three kingdoms, it is to be regretted that there is no central institution for international clearings between England, Scotland and Ireland.

Dublin, Edinburgh and Glasgow each have their own Clearing House, but to none of the central clearing houses do the banks of any of the other kingdoms belong. The larger banks have made mutual arrangements to collect each other's cheques through their London offices, but this is simply a private arrangement. In default of such arrangements, cheques must be presented through the post and a draft remitted in payment. Attempts have been made to admit the Scotch and Irish banks to the London Clearing House, but there are many difficulties in the way, and such attempts have hitherto been unsuccessful.

CHAPTER XIII.

THE FUNCTIONS OF A BANKER.

THE old definition of a banker as a man who took care of other people's money and let them have some of it when required, is a very incomplete one. A banker's function is not to take care of other people's money; he buys other people's debts and collects them; he is, in short, a dealer in money and credit.

If a man pays into his banking account a cheque drawn upon the X. Bank, he thereby sells to his banker a right to demand money from the X. Bank, and he acquires in return a right to demand the money from his own banker; the transaction has been an exchange of rights.

Before we can get a clear idea of the duties which a banker owes to the community and of the steps which he should take to make his position a secure one, it is necessary to grasp thoroughly the fact that the main function of a banker is to buy and sell rights to the possession of money. It must always be borne in mind that every right implies necessarily an obligation. If a customer gains the right to

obtain legal tender from a banker on demand, the banker necessarily incurs an obligation or liability to pay this money whenever it is demanded of him. Let us see what are the principal functions of a banker and what is the nature of the obligations he incurs.

These functions can be conveniently divided into four groups:

(1) The issue of notes.
(2) The receipt of deposits.
(3) The discounting of bills and promissory notes.
(4) The granting of loans.

(1) The issue of notes is the function of a banker which was at one time deemed of paramount importance, but is now in England restricted to the Bank of England.

(2) The receipt of deposits on "current account" by a banker is an almost identical function with that of the issue of notes. In each case the customer acquires a right to money on demand, and a banker incurs a similar obligation. In the one case this right is evidenced by a piece of paper by which the holder can transfer the right by mere delivery; in the other case, the customer's right rests upon the implied contract made with the banker at the time the account is opened, and the customer can transfer his rights by drawing and negotiating cheques.

But in opening what is called a "deposit account" —that is, an account upon which interest is allowed, and the right of drawing cheques is not usually conferred—there is a slight difference in the nature of the banker's obligations. Such accounts are repayable only upon certain stipulated notice being given,

usually seven days, though in some cases as much as two or three years. Therefore the banker's obligations are not to pay legal tender on demand as in the two preceding instances, and, as we shall see, this difference is a most important one from a banker's point of view.

(3) In discounting bills and promissory notes, a banker buys a right due at a certain fixed future time, and he gives in return to the customer an immediate right to demand money; he charges interest, called banker's discount, on the transaction in return for which the customer gets the immediate use of the money.

A. has a bill, accepted by B., payable in three months for £100. He wishes to realise the amount at once, and therefore takes the bill to his banker, who credits his account with £100 less £1 for interest. A. acquires an immediate right against the banker, who obtains a right against B. enforceable in three months' time.

It will be seen that in this case, as in two of the three preceding instances, the banker incurs obligations to pay legal tender on demand.

(4) The function of granting loans is similar to that of discounting bills; in each case the banker gives to the customer an immediate right in return for a future one.

A. applies for a loan of £1,000 to his banker. The latter opens a "loan account" in A.'s name, and debits this with £1,000 which he credits to A.'s current account. The customer therefore acquires an immediate right to £1,000 as against the banker, while the latter obtains, by means of

the loan account, the right to demand the repayment of the sum at some future time, either at a fixed period agreed beforehand, or, as is more usual, at such future time as shall be convenient to the banker, due and reasonable notice being given to A.

These are the four principal functions of a banker, and it will be noticed that in every instance, except in the case of "deposit accounts" repayable with notice, the obligation incurred by the banker is to pay legal tender *on demand.*

It may be thought that this insistence upon the nature of the rights and obligations in which a banker deals is pedantic and useless, but the key to the full appreciation of the position of a banker towards the public lies in the proper understanding of this fact, that the majority of his obligations are payable on demand. It is hardly realised in many quarters that a banker's deposits may be an actual source of weakness to him instead of strength, and that in cases of panic or of temporary lapse of confidence, his danger may be commensurate with the amount of such obligations.

Our modern banking system rests upon the assumption, based upon experience, that the whole of these demands, or even a majority of them, will not be made at the same time. Should a general distrust of credit ever take place, our banking system would collapse, for it would be quite impossible to find the gold to pay even the majority of our banking obligations. Fortunately we are justified in assuming that such a demand for legal tender is outside the range of probabilities, except in very abnormal political circumstances.

But even an unusually large demand for gold or notes, a demand slightly greater than the season of the year and the existing financial conditions warrant, is sufficient to cause bankers considerable anxiety and inconvenience.

A banker is by force of circumstances divided between two conflicting aims. On the one hand, the desire to earn a good dividend prompts him to use as much of the money under his control as he safely can. All money lying idle means loss of profit, and all money kept as a reserve against an unusual demand must lie idle. Money employed so as to earn a profit cannot be truly said to be a reserve, because if such circumstances should arise that a banker wished to get immediate control of the money, it is extremely probable that the same circumstances would prevent him from doing so. A banker most needs his reserve when there is a stringency in the market for money, and when credit is temporarily straitened, and if he has lent his reserve this is just the period when his debtor would find it most inconvenient to repay the amount.

On the one hand then a banker wishes to maintain a high rate of profit, on the other hand he wishes to make his position as secure as possible against a sudden call to pay an unusual proportion of his obligations.

To maintain this happy medium and to forestall such demands, calls for the exercise of those qualities which make a successful banker.

We can now see why bankers draw a distinction between deposit accounts and current accounts as

regards the payment of interest. While all banks except the Bank of England allow interest on deposit accounts repayable at notice, in London and the South of England it is not usual to allow any interest on current accounts, and where, as in the Midlands and North, such interest is allowed, a commission on the turnover is charged. The seven days' notice, or whatever is the agreed term, although it may not always be enforced, yet in an emergency will give the banker time to realise some of the debts owing to him. But in the case of the current account a certain proportion must be kept idle to meet possible demands for repayment, and this curtails the banker's earning power.

Let us look now for a moment at the assets of a banker available to meet his customers' demands. As has been shown, all these assets should be, to a greater or less extent, "liquid," that is, they should be of such a character that they can be promptly turned into legal tender. Of course a banker's assets do not all possess this quality to the same extent. They can be divided into several lines of defence against the attack of the banker's creditors.

First of all, there is the "Cash on hand." This is chiefly the legal tender held in the tills of his head office and branches, with a small reserve at his head office for filling up gaps at the various branches. Classed with this cash on hand we have, in the case of the larger banks, "Cash at the Bank of England," represented on the balance sheets of the smaller bankers by "Cash with London agent." This "Cash at the Bank of England" is the surplus unemployed funds of the banker, kept to meet

demands from other bankers through the Clearing House. It is called "unemployed," but we shall see in a later chapter that though not employed by the banker, yet a proportion of it is employed by the Bank of England. However, this money is always reckoned as equivalent to cash on hand, and, except in such circumstances as would compel abnormal remedies, bankers are justified in so regarding it.

Next to cash on hand and at the Bank of England there is "Money lent at call and short notice." This money is lent in the money market to bill brokers and others, and can be, and often is, called in at the shortest notice. The usual terms on which money is lent in this way are that it shall be either "day to day" or "overnight" money, or repayable at a fixed period of from six to ten days, usually called "weekly money." It is the money which the banker finds it unnecessary to keep lying quite idle, but which must be almost immediately available if necessary.

Thirdly, there are "Stock Exchange investments"; these are usually either English, Colonial or foreign government stocks, corporation stocks, and railway and other first-class debentures. They can in normal circumstances be readily sold on the Stock Exchange, and, if necessary, many of them will find a market on foreign "bourses." They have this disadvantage however from a banker's standpoint, that in such circumstances as would compel a general sale of investments by bankers it would be difficult and often impossible to find a purchaser. In acute financial crises even British

Government securities have no market except in insignificant amounts. At such times the demand is for notes or gold. A bank may be perfectly solvent and its securities be of great value, but should a scramble for notes and gold ensue, this may not save the bank from suspension.

Next to Stock Exchange securities come bills of exchange. Bills form an excellent type of a bankers' assets in one sense, because the date of their maturity is fixed, and if a banker chooses to limit or cease his discounts the amount of his liabilities in this respect will automatically decrease. But bills are of no use in an emergency. The date of their maturity cannot be hastened, and they cannot easily be sold. In some countries it is the custom of bankers to rediscount their bills with other bankers, but in England, at all events in London, this is contrary to tradition, and is a course seldom pursued, except by the overseas banks.

Last of all of a banker's assets as regards their convertibility into money, come his loans to his customers, whether secured or not.

Such assets are practically useless in a crisis. For one thing, reasonable notice of any intention to call in such loans must be given, and securities deposited to cover them can only be realised after considerable delay has ensued. Then again, the customer can only repay the amount, in the majority of cases, by means of a draft upon another banker, and the process of calling in loans will therefore often only result in a mutual exchange between bankers, which benefits no one, and is apt to recoil upon the head of the originator. Thirdly, any

attempt to enforce the repayment of loans in a crisis is a suicidal policy, because it only intensifies the feeling of nervousness and unrest which is at the root of the evil.

It is easy to see, therefore, that the essential characteristic of a banker's assets, or at least of a certain proportion of them, is convertibility into money, not merely ultimate safety. A banker's obligations are to pay legal tender on demand, and he must have access to a reserve which is available for use in any circumstances and without any delay.

CHAPTER XIV.

THE RELATIONS OF A BANKER TO HIS CUSTOMER.

WE have seen that the general relation between the banker and his customer is that of debtor and creditor, but the duties usually devolving upon the former are manifold and many-sided, and the legal relations between the two are consequently complex.

When a banker accepts a deposit from a customer with which to open a current account on the terms usually adopted by bankers, he enters into an implied contract to repay the amount in the manner directed by the customer. He engages to honour cheques drawn upon the account, and if he pays away any of the money against the wishes of his customer, whether through fraud or misrepresentation or through an error, he is, speaking generally liable to the customer for what is legally termed "conversion," that is, wrongful dealing with the property of another. Exception must be made in those cases where he is protected by statute.

But the drawee banker, that is to say, the banker paying a cheque drawn upon himself, is only liable to his customer, and not to any third party. If a banker wrongfully dishonours a customer's

cheque, he is not directly liable to the holder of the cheque, but only to his customer, and the holder can only compel payment of the cheque or obtain damages for the error through the drawer of the cheque.

The banker's authority for parting with money held at the disposal of his customer, is the latter's cheque, and he must, except where specially protected, take the consequences of acting upon an irregular document. For instance, if the drawer's signature is forged and the banker fails to detect the forgery he cannot debit the customer with the amount. If he pays a cheque before the date which it bears, or pays a bill before the date of maturity, he can only debit his customer on or after the date of the document, not before. He must pay the cheque or bill to the person named in the document, or to his order, except in the case of instruments payable to bearer, and if the cheque is "crossed," payment must only be made to a banker. The evidence of proper payment of a bill or cheque not drawn payable to bearer is the endorsement of the payee or endorsee. But special protection is afforded to the banker paying cheques drawn upon himself, by s. 60 of the Bills of Exchange Act, 1882, which is as follows: "When a bill payable to order on demand is drawn on a banker, and the banker on whom it is drawn pays the bill in good faith and in the ordinary course of business, it is not incumbent on the banker to show that the indorsement of the payee or any subsequent indorsement was made by or under the authority of the person whose indorsement it purports to be, and the banker is deemed to

have paid the bill in due course, although such indorsement has been forged or made without authority."

This section is of the utmost importance to the paying banker, as it protects him from the legal consequences of paying a cheque with a forged or unauthorised endorsement. It must be noted, however, that the endorsement must at least "purport" to be that of the payee or endorsee, that is to say, it must be on the face of it correct, and the section does not protect a banker paying on an endorsement differing in spelling from that of the person named in the instrument, or otherwise manifestly irregular.

Secondly, it must be noted that the section applies only to bills drawn on a banker payable to order on demand, that is to say, cheques. Under the terms of the Finance Act of 1853, the protection is extended to drafts or orders upon a banker payable to order on demand which are, technically speaking, not cheques according to the definition in the Bills of Exchange Act, but the protection does not apply to bills of exchange accepted payable at a banker's, and the banker paying such bills with a forged or unauthorised endorsement will be liable to the acceptor for conversion.

Thirdly, the payment must be "in the ordinary course of business," and the banker paying, in any other course, a cheque drawn upon himself, as for instance, paying a crossed cheque to any one not a banker, would lose the protection of this section.

Similar protection is afforded by section 80 of the Bills of Exchange Act, 1882, to the banker paying crossed cheques drawn upon him.

The position of a paying banker is well defined

and fairly comfortable, but that of the banker who collects a cheque drawn upon another banker either for a customer or for a third party is both complex and full of responsibility. The banker may be a "holder in due course" or he may be a mere agent for collection, either with or without the special statutory protection afforded to bankers by the Bills of Exchange Acts, 1882 and 1906.

A *bona fide* holder for value or holder in due course is defined by s. 29 (1) of the Bills of Exchange Act, 1882, as "A holder . . . who has taken a bill,* complete and regular on the face of it, under the following conditions; namely—

"(*a*) That he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact:

"(*b*) That he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it."

The position of a holder in due course is a strong one. He holds the bill "free from any defect of title of prior parties," and he can "enforce payment against all parties liable on the bill."

But if the collecting banker relies on his position as a holder for value, there is a weak spot which often invalidates his position. No one can acquire the rights of a holder in due course of a bill (the term includes a cheque) on which a previous endorsement is forged or unauthorised. No title whatever can be acquired through a forgery. In many cases, however, in which a banker collects a bill or cheque

* The word "bill" as used here includes a cheque.

with a forged endorsement, his right against his customer is practically worthless, and he may therefore be accountable to the true owner for the amount, without available recourse to any other party.

Suppose a banker opens an account with a man who is practically a stranger to him, and collects for him a cheque on which the customer has forged the endorsement. The customer withdraws his balance and absconds. The banker is not a holder and cannot rely upon the rights of a holder in due course. In the absence of any other defence he is liable to the true owner of the cheque.

But if the banker is not a holder in due course he may rely upon the protection given to him as a mere agent for collection by s. 82 of the Bills of Exchange Act, 1882, which runs as follows:

"Where a banker in good faith and without negligence receives payment *for a customer* of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment."

The Revenue Act of 1883, s. 17, extends the operation of this clause to "any document issued by a customer of any banker, and intended to enable any person or body corporate to obtain payment from such banker of the sum mentioned in such document" provided it is crossed, but, with this exception, s. 82 applies only to *crossed cheques*, and it has been held that the crossing must be placed on the cheque before it reaches the collecting

banker's hands. Open cheques, and bills other than cheques, are excluded altogether from the operation of this clause.

Secondly, the crossed cheque must be collected *for a customer.* In the case of *Capital and Counties Bank* v. *Gordon,* [1903] A. C. 240, it was decided that if a banker credited his customer's account with the amount of the cheque as cash immediately upon receipt of it, and then proceeded to collect it, he collected it not for his customer but for himself, his own position being that not of an agent for collection, but of a holder for value. This decision placed bankers in a very awkward position and deprived them of much of the protection which the section was undoubtedly intended to afford. The Central Association of Bankers therefore introduced an amending bill into Parliament, and eventually the Bills of Exchange (Crossed Cheques) Act was passed in 1906, the terms of which are as follows:

"A banker receives payment of a crossed cheque for a customer within the meaning of s. 82 of the Bills of Exchange Act, 1882, notwithstanding that he credits the customer's account with the amount of the cheque before receiving payment thereof."

The 1906 Act does not, however, apply to the class of documents covered by the Revenue Act of 1883, s. 17, which are not technically cheques.

There is a further limitation to the position of a holder in due course, that is, in the case of crossed cheques which are marked "not negotiable." This addition to the crossing of a cheque does not prevent the cheque from being negotiated, but the person taking such a cheque "shall not have and shall not

be capable of giving a better title to the cheque than that which the person from whom he took it had."

The position of the collecting banker is therefore as follows:

(1) He may be a holder in due course of the cheque or bill which he is collecting, having given his customer value for the cheque or bill previous to collection. The banker cannot claim to be a holder in due course unless he has given value for the cheque and his claim is defeated by the existence of a forged or unauthorised endorsement of any previous party, or by the existence of the words "not negotiable," if the document is a crossed cheque, and the title of any prior holder is defective.

(2) If he is not a holder in due course, he can, in the case of crossed cheques only, whether with or without the addition of the words "not negotiable," plead the protection afforded to the banker collecting such cheques for his customer by s. 82 of the Bills of Exchange Act, 1882, and the Bills of Exchange (Crossed Cheques) Act, 1906.

(3) If the collecting banker is neither a holder in due course nor protected by s. 82, he must stand or fall by the validity of his customer's title. If his customer has no title or a defective title to the bill or cheque, the banker cannot acquire a good title, and will be liable to the true owner of the cheque or bill; his only recourse will be, in the majority of cases, against his own customer.

So much for the relations of banker and customer in the ordinary operations of paying and collecting bills and cheques: the relationship is partly that of agent and principal, partly of debtor and creditor.

But this is not the only form of relation between banker and customer. In a bank advertisement a paragraph in something like the following terms will often be noticed: "The Lombard Bank will take charge of Foreign and Colonial Bonds, etc., and will detach and collect the coupons as they fall due, passing the interest to the credit of customers as received."

In this case the banker stands in the relation of trustee as well as agent for his customer. He acquires no property in the securities so lodged with him for safe custody. Where a banker discounts a bill for a customer, he becomes the legal owner of the bill; he buys it, and only has a possible right of recourse against his customer through the latter's endorsement, should the other parties to the bill fail to meet it. But in the case of securities lodged for safe custody, the position of the banker is different; he must neither sell nor pledge them, and must be prepared at any time to hand back the identical securities deposited. Should he convert them to his own use, he becomes criminally liable.

But a banker may acquire over such securities what is called a banker's lien. A particular lien is a right to retain an article until all charges in connection with that article have been satisfied; a general lien is a right to retain valuables until all debts due by the owner to the holder have been discharged; a right of sale is not necessarily given by a lien, though it is implied in a banker's lien. Bankers have, "by implication of law," a general lien over all securities deposited with them in their capacity *as*

bankers, unless there is a special contract over-riding the general lien. This general lien attaches to all bills, cheques and other securities deposited with a banker for collection. It probably does not attach to securities deposited in a locked box for safe custody, but if the customer instructs the banker to cut off and collect coupons on bonds, this is generally thought sufficient to bring the bonds under the banker's lien, since it then becomes the banker's duty so to collect the coupons, and the bonds may therefore be held to be in his possession for that purpose.

Another point to be noticed with regard to the general lien of a banker is, that it is defeated by the existence of a special lien. If securities to the value of £5,000 are lodged with a banker under a written agreement to secure a debt of £3,000, the banker acquires a special or conventional lien to the extent of the latter amount, but he cannot claim a general lien on the remaining £2,000.

A banker enters into another relation to his customer when he consents to take charge of plate, jewellery, or other similar articles. These are almost invariably deposited in a locked or sealed box or plate chest, and the banker takes no cognizance of the contents of such boxes, and makes no charge for thus taking them into his custody. He is what is called a "gratuitous bailee" for his customer, and provided he acts in good faith and takes all reasonable precautions, that is, such precautions as a business man would usually take in respect of his own property, he is not liable for any loss or damage to the articles. If, however, the banker delivers them to a third party without the

consent of the owner, as, for instance, when he acts upon an order purporting to be written by his customer, but which is in reality forged, it has been argued that he is liable to his customer for any loss accruing from his acts. The only case bearing directly upon the subject, that of *Langtry* v. *Union Bank of London* in 1896, was settled by a compromise, so that the state of the law upon the point is uncertain.

Apart from these general relations of banker and customer, there are occasions on which a banker incurs special liabilities in his dealings with the latter. In dealing with a bankrupt, for instance, special care is necessary on the part of the banker. Immediately the latter has notice of an act of bankruptcy committed by his customer, he should stop the account and refuse to pay any further cheques until the expiry of three months from the date of the act of bankruptcy. The property in the balance standing to such a customer is vested in the trustee in bankruptcy, and if a banker pays a cheque after the receipt of such notice, or after a receiving order has been made, with or without notice, he is liable to refund such amount to the trustee. It is possible that s. 46 of the Bankruptcy Act, 1914, protects the banker if he pays the amount of the cheque to the drawer himself, but not if he pays the cheque to any person other than the drawer. To come within the protection of this section the payment must be (*a*) to the person subsequently adjudged bankrupt; (*b*) be made before the date of the receiving order, and (*c*) be in the ordinary course of business or otherwise bonâ fide. It must, however, be borne

in mind that the mere calling together of a debtor's creditors and the offer to them of a composition, does not in itself constitute an "act of bankruptcy."

A banker should not open or carry on an account with an undischarged bankrupt, or he may possibly find himself liable to refund all payments made by him on the account; neither should he open an account with the wife of an undischarged bankrupt who is carrying on the business formerly belonging to her husband.

Another special relation is that of a banker to a customer who is a minor. It has in some quarters been argued that a minor, being unable to give a valid discharge for a debt, can, when he comes of age repudiate, as against his banker, cheques drawn by himself upon the latter, but the better opinion seems to be against such a strained interpretation of the protection afforded by law to minors. But although a banker can, perhaps, safely open a current account with a minor, he should certainly not allow the account to be overdrawn, as money lent to a minor cannot be recovered in a court of law.

Another case in which a banker should exercise great care is in his dealings with trustees. The English courts always extend the utmost protection to the beneficiaries of a trust, and a banker may, through imprudent action on his part, find himself held to be technically privy to a breach of trust. For instance, suppose a customer keeps two accounts, one a trust account with a credit balance, the other a personal account with an overdrawn balance; the banker presses his customer to reduce

the overdraft upon his personal account, and he thereupon transfers part of the balance standing to his trust account, in satisfaction of the overdraft upon his personal account. If the customer proves to have fraudulently misapplied the trust funds to his own use, it is probable that the banker would be held privy to such fraud and would be liable to refund the money so transferred. Again, a banker should be very careful of acting upon the authority of a single trustee, or of the majority. It is best to obtain the signature of all the trustees in every case, and if he is prudent a banker will hesitate to accept an authority signed by all the trustees granting to one of them the power to act for the whole body, as such an authority may be held to be *ultra vires*.

Lastly, a banker should act with care in his dealings with employees and other agents. Especially is this true as regards the collecting banker. Section 82 of the Bills of Exchange Act, 1882, which we saw to be the chief protection of the collecting banker, stipulates that a banker must act "without negligence," and a banker who collects for an agent cheques payable to his principal has repeatedly been held to have acted negligently. In the case of *Bissell* v. *Fox* (1885), 53 L. T. (N.S.) 193, a commercial traveller opened an account with a bank in his own name and paid in to his credit cheques payable to his principal which he had endorsed "per procuration." A "per procuration" signature "operates as notice that the agent has but a limited authority to sign," and it was held that the circum-

stances were sufficient to put the banker upon inquiry as to the validity of his customer's power to endorse in this way, and that therefore the bank did not act "without negligence." In a similar case, *Hannan's Lake View Central* v. *Armstrong* (1900), 15 T. L. R. 236, the secretary of a company endorsed a cheque payable to the company and then fraudulently paid it to his own credit, and the collecting bankers were similarly held not to have acted "without negligence."

It therefore behoves a banker to act with extreme caution in his transactions with a customer who is known to be the agent or employee of another person.

CHAPTER XV.

ENDORSEMENTS.

THE endorsement of a cheque or other bill of exchange has a varied significance. It operates as a discharge to the banker or other person who pays the bill, as evidence that the payment has been made in accordance with the mandate issued by the banker's customer. It is, moreover, the means by which a bill of exchange not payable to bearer is negotiated or transferred from one person to another in such a way as to constitute the transferee the holder of the bill. Furthermore, it is an engagement or guarantee to all subsequent holders, that the bill will be duly paid at maturity, and that the signature of the drawer and any previous endorsers, if there be any, are genuine and regular in all respects.

These differing aspects of an endorsement are not all of equal significance to the banker, and it is only so far as they affect a banker's interests that we are now concerned with them; but none of these aspects can be neglected by him. He may be either the payer of the bill or a holder, and it will there-

fore be convenient to consider the subject of endorsements, firstly, as affecting the paying banker; secondly, as affecting the banker who is collecting the bill, whether for himself or for a customer.

Except where specially protected by statute, a banker can only debit his customer's account with a cheque drawn upon him, or a bill domiciled with him by the latter, if he has paid the cheque strictly in accordance with the authority conveyed to him by the document. If this be drawn payable to bearer, the banker cannot well err in making payment, except that he must not pay a crossed bearer cheque drawn upon him except to a banker. But in paying a bill or cheque to order, the banker must, saving the statutory protection referred to, pay the amount either to the payee himself or to some one authorised by the payee; if the payee endorses in blank, the bill is thereby payable to bearer; if to an endorsee, the latter's endorsement is required. The special protection referred to is conferred by s. 60 of the Bills of Exchange Act, 1882, on the banker paying a bill to order on demand, drawn upon himself, as explained in Chapter XIV. (p. 121).

In order that the banker may obtain this protection:

(1) The document must be a bill of exchange, that is, an *unconditional* order.

(2) It must be payable "on demand," *i.e.*, it must be expressed to be payable on demand, at sight, or on presentation, or no time for payment be expressed.

(3) It must be drawn upon the banker paying it. Payment by the branch upon which a cheque is drawn to another branch of the same bank is payment within section 60.

(4) The cheque must be payable to order. By s. 8 (4) of the Act "a bill is payable to order which is expressed to be so payable, or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it should not be transferable."

(5) It must be paid "in good faith and in the ordinary course of business." A banker paying a crossed cheque drawn upon himself to any one but a banker, would not be paying it "in the ordinary course of business," and would lose the protection of this section.

(6) The endorsement must purport to be the endorsement of the payee or endorsee.

It is the last condition which is most productive of trouble to the paying banker. The question is often asked whether an endorsement in a certain form is a legal and valid endorsement, and it is often impossible to give a definite answer to such a question. There is no statute regulating the form which an endorsement or signature shall take. To some extent the courts have given decisions which may guide us in deciding the question, but it is chiefly regulated by mercantile usage and common sense. With some acquaintance with the former and the exercise of a little of the latter, added to a knowledge of a few leading general legal principles, it should not be difficult to decide for oneself most of the knotty points which occur in practice. It should be remembered that the banker is responsible only to his customer, and not to the holder of the cheque, and that there is nothing to be

gained by slackness in requiring the endorsement to be strictly correct. The policy of passing an endorsement as being "near enough" may in general be successful, but ultimate disaster is provoked. When a cheque bearing a forged endorsement is paid, it generally happens that some innocent party has to bear the loss, but that innocent party need not be the banker, unless he omits to require the endorsement to be correct in form.

In the case of a cheque (*a*) payable to an individual and endorsed by him in person, little difficulty will arise. A cheque payable to John Jones is correctly endorsed J. Jones, but Anne Smith is not a correct endorsement if the payee's name is Ann Smith. If the drawer of the cheque has misspelt the payee's name, the correct procedure is laid down in s. 32 (4) of the Bills of Exchange Act: the payee "may endorse the bill as therein described, adding, if he think fit, his proper signature." It is not usual in the United Kingdom for an endorser to use a prefix such as Mr. or Captain when signing his name, though this is quite regular in most continental countries. It is true that an endorsement in this form, if written by or under the authority of the payee and intended by him to operate as an endorsement, would be valid, and a subsequent holder would have a right of recourse against such an endorser if the cheque were dishonoured. But the banker to whom the cheque is presented for payment, cannot in most cases know the circumstances in which the cheque was endorsed, and

(*a*) In discussing the form of endorsement, the word "cheque" is used to include bill of exchange.

he therefore wisely refuses as a general rule to pay cheques so endorsed, unless the endorsement has obviously been made in a foreign country. The same remarks apply to a cheque endorsed "J. Jones, Esq." because this is obviously the usual form of address, not of signature; but a cheque endorsed "J. Jones, Capt." would be paid, because it is equally obvious that the suffix is merely descriptive. A cheque payable to a married woman in her husband's name, thus, "Mrs. John Jones," should be endorsed in the following form: "Mary Jones, wife of John Jones;" and a cheque payable to a married woman in her maiden name, say Miss Susan Smith, should be endorsed Susan Robinson, *née* Smith.

A cheque payable to more than one individual must be endorsed by all, except they are named alternately, thus, "Pay to the order of John Jones or James Smith," when only one need endorse; but in the case of dividend warrants payable to joint payees, there is a banking custom to pay on the endorsement of the first named, a custom which is recognised by s. 97 (d) of the Bills of Exchange Act.

The endorsement of a cheque payable to a firm should correspond exactly with the name of the payee or endorsee, as in the case of cheques payable to individuals. Thus James Jones & Co. is not a correct endorsement for a cheque payable to Messrs. Jones & Co. The name under which a firm carries on its business is usually a fixed and unvarying one, and if a drawer makes the cheque payable to Jones & Co., we must assume that he wishes it to be endorsed by a firm of that name and no other. It is, however, the habit of some people

to draw cheques payable to a firm in the form "Messrs. Jones." This is an anomalous and irregular method of drawing a cheque. Probably the firm's proper name is "Jones & Co.," but we must not assume this. Taken as it stands, "Messrs. Jones" means literally a number of individuals *all* named Jones. Therefore the endorsement must indicate the plural of Jones. A. & J. Jones, Jones & Son, or Jones Bros. are all correct, but Jones & Co. is not.

If a cheque is endorsed by an agent the paying banker is not bound to ascertain that the agent is duly authorised to act for his principal (Bills of Exchange Act, 1882, s. 60) but he must be careful that the endorsement purports to be that of the principal and not merely that of the agent. An agent may endorse by writing his principal's name on the bill; thus if John Smith authorises Hy. Brown to endorse cheques on his behalf, Brown may simply sign John Smith, without any indication that the signature is an agent's (Bills of Exchange Act, s. 91). This is not, however, often done in practice, and is not encouraged by bankers or commercial men. If the agent signs his own name on behalf of the principal, it should be in such a form as clearly and unmistakably to indicate that the signature is for or on behalf of the principal. A proper form of endorsement of a cheque payable to the Manchester Cotton Company is:

For the Manchester Cotton Company,
Hy. Brown,
Secretary.

Most bankers would accept an endorsement with the word "for" omitted. Whether this is wise is at least

doubtful. It might be held that the form of the endorsement necessarily implied that it was made on behalf of the company, but on the other hand in the case of *Elliott* v. *Bax-Ironside* ([1925] 2 K. B. 301, C. A.) it was held that an endorsement in the form:

Fashion Fair Exhibition, Ld.
A. B. }
C. D. } Directors

must, in the light of the surrounding circumstances, be held to be the endorsement of the individual directors, who were personally liable.

Bankers always require the agent's signature to be followed by some designatory addition indicating the character of his agency, excepting only when the signature is "per procuration." Thus, an endorsement in the form:

per pro. the Manchester Cotton Co.
John Smith,

would be considered regular, but the form:

for the Manchester Cotton Co.
John Smith,

or: *for and on behalf of* the Manchester Cotton Co.
John Smith,

would not, unless John Smith added his official title, such as secretary or manager.

This may seem a distinction without a difference, and it is very doubtful whether there is in law any such difference between the forms "per pro." and "for." But the banker has a good practical reason for drawing the distinction, and it is this. The first form, "per pro." without any further designation of agency has been held by the Courts to be valid

(see *Charles* v. *Blackwell*, 1877, 2 C.P.D. 151) but the second form "for" without the official designation has not received the sanction of the Courts and the banker therefore chooses the position of safety. His refusal to accept the doubtful form has now obtained the sanction of mercantile custom, which in matters relating to bills of exchange is always regarded with respect by the Courts where the law is not definite. There is no doubt that an endorsement in the form:

For the Manchester Cotton Co.
John Smith,

would bind the Manchester Cotton Co. if John Smith were a properly authorised agent, but whether he be such is, as a rule, beyond the power of the paying banker to judge, and the latter therefore requires the designation of his agency to be added to the endorsement. But if the official designation be added the banker must see that it is that of an agent who is, either by law or by mercantile custom, usually entrusted with the authority to bind his principal by endorsement on his behalf. Thus if John Smith adds "secretary," "manager," or "director" to his signature the character of his agency is one well known and universally recognised. But should John Smith describe himself as "foreman" or "caretaker" it would operate as notice to the banker that the agent was exceeding his powers, and in case of fraud or irregularity the banker would not be protected by s. 60 of the Bills of Exchange Act if he paid on the strength of such an endorsement. In most cases there is little difficulty in deciding whether the

authority of the agent is *prima facie* a good one, but in some instances the opinion of bankers is divided. Thus some bankers accept the endorsement of a cashier on behalf of a limited liability company, while many others refuse to do so. There is the same doubt as to the authority of a rate collector to endorse on behalf of a municipal corporation.

It is a well-known legal principle that an agent cannot delegate the authority conferred on him by his principal, and therefore any endorsement made on behalf of an agent is *prima facie* an invalid discharge of a cheque payable to the principal. It is true that it is a common practice for banks to endorse in the form:

For the Surrey Banking Co.
John Jones,
pro. Manager,

and the endorsement is usually accepted by other banks. It is, however, irregular in form and it is only the knowledge that few banks would repudiate such an endorsement if made by one of its officials that leads to its acceptance. Government departments, however, such as the Paymaster-General's Department, are stricter, and will not recognise the form as correct, nor do bankers pay cheques so endorsed if the payee is any other than a bank.

For the sake of additional clearness a tabulated statement is appended, giving examples of some of the forms of endorsement by an agent, both regular and irregular, which are commonly met with. The part of the endorsement in italics is in each case the name of the payee as described by the drawer.

REGULAR.	IRREGULAR.	DOUBTFUL.
For *The London Trading Co.*, John Smith, Secretary.	For *The London Trading Co.*, John Smith.	*The London Trading Co.*, John Smith, Secretary.
The London Trading Co., per John Smith, Secretary.	For *The London Trading Co.*, John Smith, pro. Secretary.	For *The London Trading Co.*, B. Robinson, Cashier.
per pro. *The London Trading Co.*, John Smith.	For *The London Trading Co.*, per pro. John Smith, Secretary, W. Howard.	For *The Borough of Southtown*, John Smith, Rate Collector.
Wm. Howard, by his attorney, John Smith.		
For *The London Trading Co.* John Smith, Agent.		
The London Trading Co. by John Smith, Agent.		

If a cheque is drawn payable to trustees the paying banker requires all the trustees to join in endorsing and refuses to accept a *per pro.* endorsement, or the endorsement of a single trustee on behalf of his co-trustees. This rule is very necessary, owing to the strictness with which the Courts always safeguard the interests of the beneficiaries of a trust; the knowledge that trust funds are being dealt with imposes on all those to whom such knowledge can be imputed the necessity for more than ordinary precautions for the prevention of fraud.

In the case of executors, however, each executor has in law general powers to act on behalf of the body of executors and to bind the estate, and an endorsement by a single executor on behalf of the body of executors is regular and valid, the usual form being—

For self and co-executors of John Smith,
James Martin.

The agency is expressed by the use of the word "co-executor."

An illiterate may endorse by making his or her mark in the presence of a witness to whom he or she is personally known, and the paying banker is not bound to require further verification, though in practice he usually requires the address of the witness to be stated.

An endorsement in pencil is probably legal, though obviously very undesirable, and an endorsement made entirely by means of an india-rubber or other stamp would be valid if placed on the cheque by or under the authority of the person whose endorsement it purports to be. As the paying banker is not

as a rule in the position to know whether it has been so placed, it is usual to refuse to pay cheques so endorsed.

A special endorsement controls a previous endorsement in blank; to take an example: a cheque payable to the order of John Smith is presented for payment bearing the following endorsements in the order named :—

John Smith.
Pay to the order of Hy. Jones.
Wm. Howard.

This cheque requires the endorsement of Hy. Jones before it is paid by the drawee banker.

If a bill or cheque be endorsed conditionally, the banker paying the bill or cheque may disregard the condition and incurs no liability through the condition proving to be unfulfilled.

It sometimes happens that the payee of a cheque drawn to him "or order," being perhaps of a disputatious turn of mind, claims that if presented in person the cheque does not require his endorsement, being payable to him or, alternatively, to his order. Legally the payee is possibly justified in his refusal to endorse, but the paying banker can demand a receipt, which if for an amount of £2 or more must bear a twopenny stamp, and the penalty for refusing to give such a stamped receipt is a heavy one.

So far we have been considering the endorsement of a bill of exchange, a term which includes a cheque. But there are documents in constant use which, although commonly regarded as cheques, do not fulfil the definition of a bill of exchange as contained

in the Bills of Exchange Act, and are therefore outside the provisions of s. 60 of that Act, by which the paying banker is protected in case of fraudulent endorsements. A bill of exchange must be unconditional, and therefore a draft in the form "Pay —— or order on the receipt being duly signed" is not a cheque. If the receipt were forged the paying banker could not debit the drawer with the amount, and therefore it is usual for bankers, before consenting to pay drafts in this or a similar form, to require an indemnity from their customer to protect them against this liability.

It is true that s. 19 of the Stamp Act, 1853, gives to the drawee banker the same protection as that afforded by s. 60 of the Bills of Exchange Act, in the case of any draft or order drawn upon a banker for a "sum of money payable to order on demand," but the best legal opinion is agreed that this section does not protect the banker paying a document such as the one described in the preceding paragraph when the receipt has been forged.

There is one other consideration which demands some attention before leaving the subject of the paying banker's position. S. 7 (3) of the Bills of Exchange Act states: "Where the payee is a fictitious or non-existent person the bill may be treated as payable to bearer." This section is of some protection to the banker paying bills drawn on a customer and domiciled at his bank, in which case the banker is outside the protection of s. 60. It has been decided in the well-known case of *Vagliano* v. *Bank of England* ([1891] A. C. 107, H.L.) that although the name of the payee may

be that of an existing person, yet if the latter was not and never was intended to be a party to the bill or to the transactions leading up to it, even though he was in fact a business customer of the drawer, he was "fictitious or non-existent" within the meaning of s. 7 (3) and the bankers paying the bill were entitled to treat it as payable to bearer. Attempts have been made to widen the application of this principle, which, if successful, would have covered most of the cases in which the payee's name in a bill of exchange is fraudulently inserted, but the Courts have shown an inclination to narrow rather than extend its application. Cheques payable to an impersonal payee, such as cash or wages, do not come within the section, for it is clear that an impersonal payee cannot be a "person." The banker paying such cheques without an endorsement cannot therefore rely on protection on this ground, though he might be protected on the general ground that the drawer, having drawn the cheques in such a form as to be incapable of correct endorsement, would be precluded from disputing the banker's right to charge him with the amount.

We will now turn to the collecting banker's position. If he is collecting the bill or cheque for himself he will be chiefly concerned with the endorsement considered as a guarantee of its amount. Since the passing of the Bills of Exchange (Crossed Cheques) Act, 1906, a banker is held to collect a crossed cheque for a customer whether he credits the customer with the amount before or after collection. In the former case the circumstances may sometimes be such that the banker will elect to stand as a

holder for value rather than as an agent for collection, and look for re-imbursement of a dishonoured cheque to the drawer or an endorser rather than to his own customer, but the banker will more often claim the privileges of a holder for value in dealing with bills or promissory notes discounted for a customer. In discounting bills bankers always insist on the customer's endorsement, whether the bill be payable to the latter's order or not. It may be that the banker has a legal recourse against his customer, even if the bill does not bear the latter's endorsement, but in practice the endorsement is always required. With the banker paying a cheque drawn upon him the essential point is, as we have seen, that the endorsement shall be correct in form, but when the banker is a holder, the genuineness of the endorsement is the chief desideratum. If, for instance, a bill is offered for discount with a "per procuration" endorsement, the banker must have knowledge that the person signing on behalf of the customer is duly authorised by the latter not only to act on his behalf, but in particular to endorse bills on his behalf.

In order to preserve the right of recourse against the endorser of a dishonoured bill, note or cheque, due notice of dishonour must be given. It is usual for a banker who has collected a cheque or bill for a customer to give notice merely by returning the bill, leaving the customer to give notice in turn to any previous endorsers, should there be any, but if it be desired to preserve the right of recourse against any particular endorser, notice should be sent direct to him. It is not necessary to give notice of dishonour

to the acceptor of a bill or the maker of a promissory note, but in the latter case, when the promissory note of a customer is discounted and not met at maturity, it is the usual practice of bankers to send formal notice to the maker.

When the banker is collecting the bill or cheque for a customer, the correctness and genuineness of the endorsement are still of the greatest importance to the banker, although it is often rashly assumed that the collecting banker need not concern himself with endorsements. In the case of open cheques, and bills other than those drawn on a banker on demand, the collecting banker obtains no special protection. Should the endorsement be forged he has recourse against the customer for whom he collects it, but in the event of this recourse being worthless, he will be liable to the true owner without recourse. This is a risk against which the banker cannot protect himself, for he is usually unable to verify the endorsements of previous parties.

But in the case of crossed cheques, that is of cheques crossed before they reach the banker's hands, the latter enjoys, as we have seen, the special protection against the true owner afforded by s. 82 of the Bills of Exchange Act. This protection, however, may be lost by carelessness in regard to the endorsement of such cheques. The well-known case of *Bissell and Co.* v. *Fox Brothers* has been discussed on p. 131 and we have seen there that a "per procuration" endorsement has been held to put the collecting banker on his guard, and that a disregard of the notice so conveyed will be treated as negligence within the meaning of s. 82. But an

even wider interpretation of what may be negligence on the collecting banker's part is afforded by the decision in the case of *Bavins and Sims* v. *The London and South-Western Bank* ([1900] 1 Q. B. 279). Then the defendant bank had collected for a customer a document in the form of a crossed cheque, payable to a third party, "J. Bavins, jun., and Sims." The endorsement and the receipt at the foot of the cheque were in the form "J. Bavins, Trench and Sims," and turned out to be forged. It was held that the document was not a cheque and consequently did not come within the provisions of s. 82; but Lord Justice A. L. Smith held that, even if it were a cheque, it was patent that the endorsement and the receipt were not signed in the same name as that of the payees, and that there was clearly negligence in the defendants taking this document as they did.

CHAPTER XVI.

REVOCATION OF THE CUSTOMER'S AUTHORITY.

BY s. 75 of the Bills of Exchange Act "the duty and authority of a banker to pay a cheque drawn on him by his customer are determined by:

"(1) Countermand of payment.

"(2) Notice of the customer's death."

There are, in addition to these two, other circumstances which terminate the banker's "duty and authority," as we shall see later. Direct countermand may be either in writing or verbal, though in the latter case it is obviously desirable that it should be reduced to writing From the words of the Master of the Rolls in the case of *Curtice* v. *The London, City and Midland Bank* ([1908] 1 K. B. 293), it is very doubtful whether countermand by telegram is sufficient to impose a duty on the banker to refuse payment without confirmation of the genuineness of the telegram, though such a telegram would necessarily put the banker on his guard. The prudent course in such cases would be to return the cheque with an answer explaining the circumstances and requesting further presentation. It is also clear from this case that the countermand must actually reach the banker before it

is effective; it is not sufficient, for instance, that it shall merely have been entrusted to the post.

The customer's right to countermand payment exists up to the time of payment of the cheque. What is the legal definition of "payment" is not quite clear in all circumstances, but it is distinct from a mere promise of the banker that the cheque will be paid upon presentation. For instance, it is occasionally the practice for a bank to telegraph on behalf of a customer who is the holder of a cheque to the bank upon which it is drawn, "May I pay X.'s cheque for ten pounds?" If the drawer replies "Yes, if in order," he binds himself to pay the cheque to the presenting bank, unless it is technically irregular, but probably X. retains his right to stop payment up to the time the cheque is presented and paid. If X. in the interim exercises this right, the drawer will be in the awkward position of being compelled to pay the cheque and being unable to debit his customer. The answer "Yes, if in order" is not therefore a safe reply to give in such cases, except, perhaps, when given to another branch of the same bank. A better reply is "Cheque would be paid if in our hands and in order."

In this connection the interesting question arises, What effect does the "marking" of a cheque by the banker upon whom it is drawn have upon the drawer's right of countermanding payment? By "marking" a cheque is meant the initialling of the cheque by the bank on which it is drawn as an indication that it will be paid when presented. If the cheque is marked at the request of the drawer, it is fairly certain that the latter is pre-

cluded from countermanding payment; he cannot rid himself of the responsibility for the consequences of an act done at his own request. If the cheque is marked at the request of the holder, or of some other party, for the purpose of furthering the negotiability of the cheque, the position is very different. The practice of marking cheques with this object, though very usual in the United States, where it has received legal sanction, is now regarded by bankers in this country with growing disfavour. At one time a marked cheque was used in settling transactions where deeds or other securities had to change hands, but many bankers now insist on a banker's draft being issued instead of the customer's cheque being marked. Such a marking, as Sir John Paget points out, (*a*) cannot be regarded as equivalent to payment, as its object is to facilitate the negotiation, not the discharge, of the cheque. The drawer's right to countermand payment in all probability, therefore, continues to exist until the cheque is presented and paid, and the banker may find himself bound to pay the cheque while unable to debit the drawer's account. Moreover, as he has not given value for the cheque, he is not a holder in due course, and cannot as such enforce payment against the drawer.

The most frequent method of marking cheques is in circumstances in which the collecting banker is desirous of knowing the fate of the cheque after the usual hours in which cheques can be presented for payment.

For instance, cheques drawn on a London Clearing

(*a*) "Law of Banking," 3rd Edition, p. 195.

Bank which are too late to reach the Clearing House in time for the day's clearing are frequently presented direct to the bank on which they are drawn in order that they may be marked, and are then presented for payment on the following day. This is often necessitated by the rule among the London Clearing Banks that they may not present for payment cheques drawn on each other except through the Clearing House. A similar custom prevails in many provincial towns of marking cheques received too late for presentation in the daily local exchange.

It will be observed that the circumstances in which such cheques are marked are quite different from those just discussed. The marking is not done to facilitate negotiation, it is what Mr. Justice Buckley calls "constructive payment." In his judgment in "*In re Beaumont, Beaumont* v. *Ewbank*" ([1902] 1 Ch. 889) he says, speaking of a banker who promised to pay a cheque subject to the confirmation of the drawer's signature. "He (Vice-Chancellor Stewart) must have so decided either because the cheque was constructively paid, the bankers having substantially said they would pay, so that the payment constructively related back to the date of payment; or because the bankers had in effect said, 'The account is in credit, and we will hold enough of the balance to satisfy the cheque, subject to the signature being shown to be genuine.'" (*a*)

By marking the cheque the banker has definitely bound himself to the holder of the cheque, and it can therefore be argued that he has constructively paid

(*a*) Hart, "Law of Banking," 3rd ed., p. 331.

the cheque and that the drawer no longer has the right to countermand payment. The same arguments might be used in the circumstances mentioned above, where a banker has telegraphed to another banker permission to pay a cheque if in order, but the argument does not seem so strong when so applied, for in this case the cheque has never reached the hands of the banker on whom it is drawn, and presentment for payment is necessary to charge the drawer (Bills of Exchange Act, s. 45).

The mere cancelling of a cheque by the banker upon whom it is drawn does not terminate the customer's right to countermand payment. If, for instance, a cheque on a country bank or branch bank is presented through the Country Clearing, it is customary in many cases to cancel the cheque immediately and debit the customer's account. But the banker is given until the end of the day in which to pay or return the cheque, and, unless the banker has bound himself to pay it, it seems certain that the drawer can exercise his right of countermand at any time during the day, although the cheque may have been cancelled and debited to his account.

If the cheque is in the hands of a "holder in due course," the drawer can be compelled to pay it, but this does not affect the position of the paying banker; the latter is responsible only to his customer the drawer, and if payment is countermanded the banker *must* refuse to pay, without regard to the rights of the holder. On receipt of the order to stop payment a note of the particulars of the cheque will be entered in the "Stop Register,"

all the tellers or cashiers will be advised, and if the customer has a credit at any other branches or banks, it must not be forgotten to advise them also.

Notice of the death of the customer also revokes the banker's authority to pay. By notice is meant such information as a reasonable business man would act upon. A banker who has paid a cheque drawn by a customer of whose decease he has had such notice, cannot debit the customer's account, but must claim for the amount against the deceased's estate.

But notice of the death of an agent empowered to sign cheques on his principal's account does not revoke the authority of the banker to pay cheques signed by the agent. Thus, a cheque drawn on Thomas Smith's account signed "per pro. Thos. Smith, Hy. Brown," is presented for payment. If notice of Thos. Smith's death has been received, the cheque will be returned with the answer, "Drawer deceased," but if notice of Hy. Brown's death has been received the cheque will be paid. On the same analogy a cheque drawn on account of a company or other corporation will be paid, although notice of the death of the official or officials signing on its behalf has been received. With regard to the account of a firm, every partner is by s. 5 of the Partnership Act, 1890, declared to be an agent of the firm and his other partners, for the purpose of the business of the partnership. Notice of the death of a partner does not therefore revoke the banker's authority to pay cheques drawn by him on account of the firm. It is true that, subject to

any agreement between the partners, the death of a partner dissolves the partnership, but the surviving partners are empowered to operate on the account for the purpose of winding up the partnership.

As regards a joint account, not being a partnership, upon the death of one of the parties, the joint property is *prima facie* vested in the survivors, who, upon proof of death, can control the balance of the account, unless the executor of the deceased person should intervene. If the banker's instructions are that all the parties must unite in drawing cheques, upon notice of the death of one of them, cheques drawn before his death will be paid. If, however, the instructions are that either or any one of the parties may draw alone, cheques drawn by a party of whose death notice has been received should, in the opinion of the Council of the Institute of Bankers, be returned unpaid.

As was stated above, there are other circumstances which terminate a banker's authority to pay his customer's cheques besides those specified in the Bills of Exchange Act. If a receiving order in bankruptcy has been made against a customer, or the banker has received notice that the customer has committed an act of bankruptcy, the banker is bound to refuse payment of the cheques. In the former case, notice to the banker is immaterial; once the receiving order is made, notice is imputed to every one, and a banker paying a cheque in ignorance of the order cannot debit the bankrupt's account. If a customer commits an available act of bankruptcy, that is an act upon which a creditor is enabled to base a bankruptcy petition, the banker cannot

safely pay cheques on the account, presuming he has notice of the act of bankruptcy, until after three months from the date of the act, although no petition has been lodged, the reason being that any creditor may lodge the petition before the expiration of the three months, and the effect of the petition relates back to the time at which the banker, or other debtor of the bankrupt has had notice of the act of bankruptcy (see *ante*, pages 129 and 130).

Speaking generally, the banker dealing with a firm, a joint customer, or an agent is in a similar position as regards paying cheques when he receives notice of the bankruptcy of one of the parties as he is when receiving notice of death. It should be noted, however, that if a partner becomes bankrupt the solvent partners may operate on the account for the purposes of winding up the partnership, but cheques signed by the bankrupt previous to the act of bankruptcy should not be paid without the confirmation of the other partners. It should also be remembered that if a firm becomes bankrupt all the partners also are bankrupt, and cheques on their private accounts must not be paid.

A fourth instance in which the banker's authority to pay his customer's cheques is revoked is when an order of the Court has been served upon the banker restraining him from parting with the balance at the customer's credit. This order may take the form of an injunction, but the more usual form which a banker meets is a garnishee order. When a creditor has obtained judgment of the Court against his debtor he may apply for an order of the Court attaching any debt which he may have

ascertained to be due to his debtor from a third party. This garnishee order attaches the *whole* of the debt owing or accruing due to the debtor, so that a banker who has been served with such an order cannot safely pay any cheques, however much the customer's balance may exceed the debt for which judgment has been obtained, together with the probable amount of the costs incurred. Bankers sometimes use their discretion and pay cheques, provided the balance remaining is sufficient to discharge the debt of the customer, but there is always the risk that part of the customer's balance may not be his own, but be held in trust. If such were the case the garnishee order would not attach the trust funds, and the banker might be called upon to refund the money with which he had parted. If the customer has a deposit account repayable only at an agreed notice, as is usually the case, the garnishee order probably does not attach the balance of the deposit, unless notice of withdrawal has been given to the banker previous to the date when the garnishee order was served upon him, as without such notice the amount is not "owing or accruing due." The decisions of the County Courts have, however, been contradictory and there is apparently no judgment in the higher courts to guide us.

If a customer is declared insane by legal inquisition and a committee appointed to manage his affairs, his banker must refuse payment of the lunatic's cheques. If, however, the banker has knowledge that his customer is insane, but no inquisition has been held, the position of the banker is a difficult one, and the law is not very

explicit as to the banker's duty. From the judgment of the Court of Appeal in the case of *Drew* v. *Nunn* ((1879), 4 Q. B. D., 661) the position seems to be this: If the banker has knowledge that the customer is so far insane that he is incapable of managing his own affairs, he would not be justified in paying his cheques, and may be held liable to refund money so paid. Notice that the customer was confined in a lunatic asylum would apparently be sufficient notice of incapacity. The banker, however, will in practice require clear knowledge of incapacity before taking the serious step of dishonouring his customer's cheques, and Lord Justice Brett, in the case above quoted, was most explicit upon this point. "I may remark," he said, "that from the mere fact of mental derangement it ought not to be assumed that a person is incompetent to contract; mere weakness of mind or partial derangement is insufficient to exempt a person from responsibility upon the engagements into which he has entered."

There is one other circumstance which may terminate a banker's duty and authority to pay cheques, but it is one which would seldom occur. If the banker has clear knowledge that the customer is drawing money for an unlawful purpose, as, for instance, if he is drawing cheques on an account which the banker knows to be a trust account and for a purpose which would constitute a breach of trust, the banker should refuse payment. It must be borne in mind, however, that no banker would so act without unmistakable proof of *mala fides*, or he might find himself in a very awkward position.

CHAPTER XVII.

BANKERS AND BORROWERS.—I.

IT is very difficult and somewhat dangerous to attempt to lay down on paper the rules which should guide a banker in lending money. This is above all the function which a practical business man can alone fulfil with complete success. It may be easy to formulate rules, but in practice such rules are apt to be rather rudely brushed aside. In order to lend money with success, theoretical knowledge is of less importance than a combination of business virtues, such as judgment and knowledge of character, with the possession of thoroughly reliable local information. But although in individual cases theory is subordinate to practice, yet in dealing with transactions in the mass some rule of conduct is necessary, or a large bank will soon find itself in difficulties. The branch manager will often find that local conditions render necessary the lending of money in a direction or by a method which runs counter to the line of policy pursued by his directors. It may be that the representations of the manager will carry the day, but he is often

rather galled to find that what he regards as a golden opportunity for making money is heedlessly thrown away by his directors. Probably the branch manager has not sufficiently realised that in dealing with the advances of the bank as a whole, certain rules must be for safety's sake laid down, and more or less closely adhered to.

It is intended here to give some idea of the general principles which should guide a banker in lending money, though with this proviso, that circumstances may often arise which necessitate the breaking of the rules laid down. A banker, like most business men, is often constrained to act against his better judgment. He may be influenced in his loans by the fear of offending wealthy connections of his customer by a refusal, or, having made a loan without security, he will probably find it better to accept later on an unsatisfactory form of security rather than face a heavy risk of loss.

First of all then it will be convenient to consider the classes of borrowers with which a banker usually has to deal. These can be divided into three:

(1) Private individuals, *i.e.*, those not engaged in trade or business.
(2) Commercial firms or individuals.
(3) Companies registered under the Companies Acts.

This is not a complete list, for it excludes such borrowers as municipal and educational authorities, but it includes all we have room to discuss here.

First then, in dealing with private individuals, it should be noted that such people should not, as a general rule, offer bills for discount. Bills arise out of commercial transactions, and private individuals neither pay their debts nor are they paid by means of bills. Sometimes they may offer bank bills for discount, and this may be quite in accordance with expectation. The customer may have, for instance, property in one of the Colonies, and may have money remitted to him by means of, say, a sixty days' sight bank bill; in this case, the customer will often wish to discount the bill with his banker. Nevertheless, as a general rule, bills offered for discount by a private individual should be regarded with suspicion; they may probably turn out to be "accommodation" bills. An accommodation bill is one which an obliging friend or other person has accepted in order to enable the holder to borrow money upon it, but without being a party to any monetary transaction upon which the bill has been based. It is always doubtful whether an accommodation bill will be met at maturity. The obliging friend has probably been informed that the bill will be "taken up" or "retired" before maturity, and he has therefore taken no steps to meet the bill. Borrowers are, however, proverbially sanguine, and it often happens that the drawer or endorser of the bill is unable to take it up before maturity, and the bill is consequently dishonoured, in which case the banker may find that his only resource is to renew the bill, and hope that time will improve matters.

Secondly, in advancing money to a private individual, remember that however large his income may be, it may cease at his death. Supposing the customer is a barrister or doctor earning several thousands a year, but living right up to his income and saving no money. His banker may feel tempted to grant him a temporary loan without security, relying on the extent of his "turnover," that is, the amount of money passing through his account. But in case of the customer's death, what is the banker's position? If the customer has spent all his income and has no capital, the debt will be worthless. It is an error to suppose that because a man lives in good style and keeps up appearances, he is necessarily a wealthy man. Of course, a glance at the customer's account in the ledger will usually show whether he has money invested. If he has bought Stock Exchange securities, the dividends will be periodically credited. If, on the other hand, he has invested his money in landed or other property, it may not be easy to distinguish between the income from these sources and other receipts.

In lending money to the second class of customers, commercial men or firms, the banker has different considerations forced upon his notice. In dealing with such men, a banker is often asked to make temporary advances without security. A business man may have sudden and unexpected calls for payment which he cannot easily meet, but which must not be disregarded. A commercial man's credit, his reputation as a man of means, is a tender thing, a part of his capital,

and in order to protect it he may have to make a sudden call upon his banker.

Something can be told from the amount of a business man's "turnover," but this knowledge must be used with caution. He may be buying on long credit and selling for cash, or he may be speculating, and the appearance of his account be deceptive. Some banks ask their customer to give them in confidence a rough balance-sheet showing the state of his finances. It may be asked what is the use of a balance-sheet which only possesses the authority of the customer's written statement, and which the banker is unable to verify? It may be entirely fraudulent. The answer is, that it is almost impossible in this matter for a banker to protect himself against deliberate fraud on the part of a customer. Very few men would go so far as to sign a fraudulent balance-sheet, knowing that they would by so doing render themselves criminally liable. The risk of fraudulent dealing is an ordinary business risk which a banker is at times compelled to run. If the customer is such a one that his written statement cannot be trusted, it will be advisable not to lend to him except upon good security. But in considering a balance-sheet with a view to lending money, although the possibility of fraud can in most cases be disregarded, yet the banker, if he is wise, will make a liberal allowance for the exaggerated optimism which nearly always characterises a borrower, however honest he may be.

In dealing with trading firms, it is well to remember that the act of one partner binds the firm. When possible, it is better, in making a

loan, to obtain the consent or authority of all the partners, but it is not a legal necessity. Not only is this so, but a banker need not take special steps to prove that an individual is actually a partner in a business firm. Provided the firm act in such a manner as to induce the public to believe that an individual is a partner, they are bound by the acts of such a man, and cannot repudiate them on the ground of lack of authority, although no deed of partnership may exist.

In dealing with the third class of borrowers, viz., companies registered under the Companies Acts, there are one or two important points to remember.

First of all, a company may have no power to borrow money at all, or may only have a limited power to borrow to a restricted amount, or under certain conditions.

A company's powers of borrowing are determined by its memorandum and articles of association, and it is necessary to see a copy of these before lending money to the company. Otherwise it may be discovered that the directors have acted *ultra vires* by so borrowing, the effect being that the shareholders of the company are not bound by the acts of its directors, and the only remedy of the bank is against the directors personally.

It must not be forgotten that every one having dealings with a company registered under the Companies Acts is held to have knowledge of the memorandum and articles of association by which the company is governed, and the same rule applies to corporate bodies governed by special Acts of Parliament.

Secondly, caution is necessary in lending money to a newly registered company. Bankers have often to help to finance new companies floated under their auspices; but the Companies Act, 1929, provides that no contracts entered into by a company shall be binding until such company is entitled to commence business; and in order to do this the company must first obtain from the Registrar of Public Companies a certificate stating that certain formalities have been carried out and that a certain proportion of the capital has been allotted. In lending money to newly formed companies it may be advisable for the banker to ask to see a copy not only of the articles of association but also of the registrar's certificate that the company is entitled to commence business.

The third point to remember is the obvious one that if the liability of the company is registered as "limited" the shareholders of the company are not responsible for its debts beyond the nominal amount of their shares. The debts of a common law partnership can be recovered against the private estate of any or all of the parties; but the creditor of a limited company is denied this privilege. Moreover, if the company has issued debentures, the debenture holders probably have a first charge over the whole of the unassigned assets of the company; in such cases when the company finds itself in difficulties the trustee of the debenture holders will intervene, and by the time his demands have been satisfied there is seldom much left for division among the ordinary creditors of the company. A banker will therefore

usually hesitate before lending money to a limited company unless security be deposited; but in cases where a temporary loan is required, and it is not convenient to deposit Stock Exchange securities or title deeds, it is very usual for the banker to accept a joint and several promissory note signed by two or more of the directors personally. This is discounted, and the proceeds placed to the credit of the company. At maturity the company will probably be in the position to pay the amount; but if not, the banker has a remedy against the private estate of each or all of the directors who signed the note. If the loan is required for a longer period a joint and several guarantee may be more satisfactory.

Now that we have gained some idea of the chief classes of borrowers, it will be advisable to examine the different methods of borrowing from a banker, and these can again be conveniently divided into three heads:

(1) By the discount of bills and promissory notes.

(2) By overdraft upon current account.

(3) By loan account.

(1) When a bill or a batch of bills is offered to a banker by a customer for discount, the first thing the banker has to decide is whether the customer's account is a sufficiently good one to justify the transaction. A banker will naturally hesitate to discount bills for a customer whose cheques he is sometimes forced to dishonour, for it is very probable that the bills offered by such a man will not be reliable. He will also probably refuse to discount for a customer whom he does not know to be thoroughly respectable, for a banker is, as

a rule, ignorant of the signature of the acceptor to a bill offered for discount, and relies upon the honesty of his customer.

Having decided that the customer's account warrants the transaction, the banker will see that the bill is correct in form, drawn upon properly stamped paper and duly accepted. He will see that the customer endorses the bill, whether it be payable to his order or not, for in case of dishonour the banker's remedy against his customer lies through the latter's signature either as drawer or endorser. As a rule a banker will not discount bills having more than six months to run.

Nearly all bills offered for discount are accepted payable at a bank. The discounting banker will in these cases make a confidential inquiry of the acceptor's banker, asking for the latter's opinion of the standing and respectability of the acceptor. This opinion he will record for future use in his acceptor's register, in which book it will be found convenient to make a note of any dishonoured bills, in order that if necessary he can avoid similar bills in the future. If the opinion is satisfactory the customer will be credited with the full amount of the bill, which will be debited to the "bills discounted" account. Interest on the unexpired term of the bill, at a rate to be agreed upon, and usually bearing a fixed relation to the current Bank of England discount rate, will then be debited to the customer and credited to the banker's discount account.

This operation, which is the ordinary routine of discounting a bill, is now complete. It only remains

to make a note of the due date of the bill in the bill diary in order that the bill may be duly presented, for if through inadvertence presentation be neglected the consequences may be serious to the banker, since the drawer's and endorser's liability will be terminated by the omission, and the banker's only recourse will be against the acceptor. If on due presentation the bill is dishonoured, notice must be given to the customer not later than the day following such dishonour, and to the drawer or any other endorser against whom the banker may wish to have recourse.

In discounting promissory notes, the proceeding is similar, except that the maker of the note stands in the position of the acceptor of the bill. A banker will sometimes advance money to a customer of good standing by discounting the customer's own promissory note; if he wishes an additional safeguard, he will ask the customer to get a friend to join with him in a "joint and several" promissory note, in which case action may, in the event of dishonour, be taken against either or both for the full amount of the note.

(2) and (3). The difference between lending money by an overdraft upon current account and by loan account is as follows: In the former case the customer pays interest on the daily balance standing to his debit, this being charged half-yearly. In the latter case, the customer opens a loan account and transfers from this account to his current account either the whole stipulated sum or such a portion of it, as he is likely to require in the immediate future. He will be expected to keep a

credit balance on his current account of such an amount as the banker thinks sufficient, according to the character of the account. He will pay interest on the sum standing to the debit of his loan account.

At first sight it may seem as though every customer would prefer to borrow by the former method, that is, by overdraft, because in this case he only pays interest on the sum he actually uses, whereas in the latter case, part of the sum for which he pays interest is standing to his credit on current account. But to counterbalance this, a banker is usually willing to grant a loan at a slightly lower rate of interest than he will charge on an overdraft, while in the latter case he also usually charges a small commission to recoup himself for the trouble and expense of keeping the customer's account, an expense which is covered in the case of a loan account by the credit balance kept on the current account.

The next chapter will treat of the various forms of security which are deposited with a banker to cover loans made by him. Before passing on to this, I should like to reiterate what I have previously mentioned as to the character of a banker's loans. It is not a banker's function to lend money permanently.

Fortunately we have not had to face the failure of one of our larger banks for many years, but minor failures have been frequent, and it is no exaggeration to say that by far the larger proportion of these have resulted from assets being locked up in large loans to a few individuals—loans which have gradually acquired a permanent character, and ended by

becoming bad debts. The province of a banker is to tide over temporary lack of ready money, not to provide capital on which the customer carries on his business.

No doubt a banker in this as in other directions has often in individual cases to run counter to his general policy, but he should never lose sight of the fact that his obligations are to pay on demand, and keeping this ever in mind, he should always hesitate to lock up his money in permanent loans.

CHAPTER XVIII.

BANKERS AND BORROWERS.—II.

AS we have seen, a banker in some cases is willing to lend money to a good customer for a short period without security, but in most cases he requires the deposit of some form of security as cover to the loan.

Perhaps the most usual form is the deposit of Stock Exchange securities. The character of the greater part of a banker's security depends upon the character of his business. In a neighbourhood like the West End of London, Stock Exchange securities will perhaps greatly outnumber the remaining forms. In a country town, it may be that deeds of title to land form a large proportion; in a seaport town very likely a considerable amount of money will be lent on bills of lading and other shipping documents.

Government stocks, good debentures and other "gilt-edged" securities, form excellent cover for a banker against advances. He can either acquire a general lien against such securities, an equitable title or a legal title. The application of the banker's lien has been considered in a former chapter. If the

securities are deposited under a memorandum or deed of deposit, or even without any written evidence provided they are deposited for the purpose of securing an advance, the banker, in the case of negotiable securities, such as bearer bonds and scrip, acquires upon the default of his customer, a full legal title. Provided he took the securities without legal "notice" of any defect in his customer's title, he can maintain his right to them against all comers, notwithstanding any such possible defects. The banker must however be careful that circumstances do not occur which can be held to affect him with "notice." The Courts are in many cases, especially where a trust is concerned, strict in their interpretation of the term notice, and if anything should occur to make the banker suspect that the securities are held by his customer in trust, he should either obtain a clear explanation or refuse to accept the security.

In the case of shares of companies registered under the Companies Acts, the deposit of the share certificates gives the banker only an equitable title. The practical difference between the two is that a legal title has the priority over a mere equitable title. The danger of an equitable title is that, unknown to the banker, some one else may have either a prior equitable title or a legal title, whether prior or subsequent is as a rule immaterial, in which case the banker will have to surrender the securities. In order that a banker may obtain a legal title to shares in a company, it is necessary in nearly all companies to have the shares transferred into the name of the banker, or, as is usually done, into the names of some nominees of the banker, and

also to have this transfer registered in the books of the company. Until the transfer has been so registered, the banker will have but an equitable title, which will be liable to be postponed to a prior equitable title, either of the company or perhaps in favour of some trust of which the banker was unaware.

Practice varies among bankers, but it is certainly wiser in the majority of cases to have the shares transferred and registered. At one time the custom prevailed of obtaining the customer's signature to a blank transfer deed, which could be filled up and registered when the occasion demanded, but it has been decided by the Court of Appeal that a transfer so drawn up is not a legal or effective document, if the articles of association of the company require the transfer of shares to be by deed.

Cases may arise where it is inexpedient to obtain a legal title to shares, as for instance when the shares are not fully paid. Bankers will not willingly accept as security shares on which there is a balance of uncalled capital. Mining shares and certain classes of industrial shares are avoided by the prudent banker, not only on account of their speculative character, but also by reason of the fact that they are seldom fully paid; but if a banker is compelled to accept such shares for want of a better security, it is wiser not to transfer the shares, in order that the banker may not be saddled with the responsibility for the uncalled balance.

Another very general form of security offered to a banker consists of title deeds to landed property. This forms a very fair class of banker's security,

though it suffers from the disadvantage that such property is not always easily marketable, and a forced sale is apt to result in a price very much below the normal one.

As in the case of Stock Exchange securities, a banker may either obtain a legal mortgage or an equitable mortgage.

Bankers often obtain the deposit of the title deeds under a memorandum, which constitutes an equitable mortgage. The only drawback to this is, as already noted, the possibility of its being postponed to a prior equitable mortgage or a later legal mortgage, but the latter danger can be guarded against if the banker keeps the title deeds continuously in his possession, and does not part with them even for a short interval, as without the possession of the deeds it is not possible to execute a legal mortgage. Of late years, however, the practice of requiring a legal mortgage has grown in favour among the banks.

In dealing with title deeds there are several points to remember :—

(1) The deeds should be immediately submitted to a competent solicitor for a report as to their genuineness and correctness.

(2) The property should be valued at frequent intervals. Certain classes of house property rapidly deteriorate in value if they are not kept in a proper condition of repair.

(3) In dealing with leasehold properties, allowance must be made for the fact that their value declines as the term of expiry approaches.

(4) The customer should be required to produce the receipt for the ground rent of leasehold properties

as soon as the period for payment has passed, since, if this be not paid, the lease may be forfeited.

(5) All house property should be insured against fire, and the customer should produce for the banker's inspection the receipt for each annual premium as it falls due.

(6) Before the advance is made, the Register of Land Charges should be searched in order to ascertain whether there are any existing charges having priority over that of the bank.

(7) Second mortgages of all kinds should be avoided. The first mortgagee may elect to foreclose and a forced sale may leave nothing for the second mortgagee.

(8) If notice, *i.e.*, legal "notice," as before explained, be received of a second charge on the property, the banker cannot, after receipt of the notice, safely continue to make advances. All such advances will create a charge postponed to the second charge of which notice was received.

Another form of security sometimes offered to a banker is a life insurance policy. The amount a banker can safely lend on a policy will not exceed its "surrender value." This is the amount, fixed by the company issuing the policy, which it is willing to pay for its surrender, and is a proportion of the actual amount of the premiums already paid. There is a general opinion that a banker can acquire no right to retain a life policy unless it has been deposited under a memorandum, but this opinion is apparently unwarranted, and if the policy has been left with the banker for the purpose of securing an advance, the banker probably has a charge upon it, although no memorandum of deposit may exist.

The next form of security which we have to notice is the guarantee of a third party, which may be either under hand or seal, though the former is the method more usually adopted.

The weak point of a guarantee is that the banker is not always in a position to judge whether the guarantor is thoroughly reliable. In most cases he will have to rely upon the confidential opinion of another banker, and in giving such opinions all bankers are naturally prone to take the most favourable view of their own customer's position.

Most banks have their own form of guarantee drawn up by an expert lawyer, but it may be mentioned that a guarantee should be expressed to be a "continuing" guarantee, covering not only existing debts due from the person guaranteed, but all future debts incurred by him until the guarantee is terminated, either by notice or by the death or bankruptcy of the guarantor.

If a guarantor dies or gives notice that he wishes the guarantee to cease, the banker upon hearing of the death, or at the expiration of the notice, should at once stop the account of his customer and refuse all further transactions on it. This is imperative. If the account is continued after the expiration of the notice or the death of the guarantor, every amount paid to the credit of the account reduces the debt, but every cheque paid creates a fresh debt. This principle is called the general rule of the appropriation of payments, or "the rule in Clayton's case," and should never be lost sight of by a banker in his dealings with a customer to whom an overdraft has been granted.

If a debtor, when paying money to his creditor, omits to appropriate the payment to a particular item or account, the creditor may himself appropriate it at his discretion. Failing appropriation by either debtor or creditor at the time of payment, the money is deemed to be appropriated in satisfaction of the debt first incurred in order of date.

An illustration will perhaps explain the meaning of this more clearly. Suppose John Smith has an overdrawn balance of £100 on his account. He calls in at the bank, pays in a cheque for £100, and draws out £100 to pay his week's wages. From a legal point of view he has extinguished his original debt and created a new one.

Now let us suppose that the overdraft is secured by a continuing guarantee of John Brown for £100. John Brown gives notice that he wishes to terminate the guarantee, and at the expiration of the notice Smith's overdraft is £95. Smith's banker neglects to stop the account, and Smith comes to the bank next day, pays in £50 to his credit and draws out £25, leaving his balance £70. Brown's liability is, however, reduced to £45. The cheque for £25 constituted a new advance from the banker to Smith, and was not therefore covered by Brown's guarantee, although the £50 paid in is deemed to have paid off part of the old debt.

One of the chief advantages of a guarantee is experienced in the case of the bankruptcy of the customer whose account is guaranteed. If the account is secured by the deposit of bonds, title deeds, or similar securities belonging to the customer, the banker will have to realise them before proving

against the estate in bankruptcy, or value them and deduct the value from the amount to be proved. But with a properly drawn guarantee, he can, if thought expedient, prove against the estate for the full amount of his debt, and then require the guarantor to pay the balance, or so much of the balance as the full amount of the guarantee will cover.

In many cases there will be an important difference between these two methods of realising the securities. Suppose the overdraft of the bankrupt is £150, secured by the deposit of bonds worth £100 in the one case, and a guarantee for £100 in the other. In the first case the banker will be able to prove for £50 only, and if the dividend is 10*s*. in the pound, he loses £25. In the second case he proves for £150, which, with the same dividend, will leave a debt of £75, and he can then claim the repayment of the whole of this balance by the guarantor.

A similar advantage is gained by the banker in all cases where the security lodged belongs, not to the debtor, but to a third party.

One other form of security may be mentioned—that is, documents of title to goods. The most important of these is a bill of lading, which is in effect a certificate given by the master of a ship that certain goods have been entrusted to his possession, and an undertaking to deliver them at the end of the voyage, subject to certain conditions mentioned in the bill. While the goods are at sea the bill of lading is evidence of ownership, and the right to obtain delivery of the goods can be transferred by the negotiation of the bill of lading.

A bill of lading is almost always drawn in a "set"; that is, there are two or three identical parts, numbered one, two, and three, and care must be taken to gain possession of all the parts. The master of the ship or warehouseman will deliver the goods on the presentation of any one part of the bill, and the law justifies him in this course. If the holder of a bill of lading fraudulently negotiates each part to a separate individual, the man to whom the transfer is made first in point of time has a better title than the later ones, but the man who first presents the part in his possession will probably obtain possession of the goods. The only safe method, therefore, is to obtain possession of all the parts of the bill.

A bill of lading usually states that so many packages, boxes, bales of merchandise, have been shipped, but it does not guarantee the contents of the packages, and the shipowner is not responsible for the genuineness of the goods. A policy of insurance should, however, always be attached to the bill, and an invoice, and these will afford a fair criterion of the value of the goods, though they will not always be a protection against fraud on the part of the shipper.

It must be remembered that a bill of lading confers a right to obtain possession of the goods mentioned in it, but it does not necessarily confer a valid title to the goods. The banker may find, after he has obtained the goods, that the man to whom he lent the money had no right to pledge the goods, and he may, therefore, have to surrender them to the true owner. In this connection the

Factors Act, 1889, is a great protection to bankers. It enacts that if goods are entrusted to a mercantile agent in the usual course of his business, and the mercantile agent wrongfully pledges them, yet a man who innocently advances money on the goods or the documents of title to them shall be able to enforce the contract against the true owner, although the latter has not sanctioned the pledge. A mercantile agent is defined as a person "having in the customary course of his business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods."

Finally, to return to the topic of lending generally, there are two points which a banker should always bear in mind.

First, the mistake of optimism should be avoided. Do not be over sanguine. It is advisable to allow a liberal margin between the value of the securities and the amount of money advanced against them, as provision against possible depreciation. Do not be too ready to accept a customer's valuation of his assets or of his probable profits in the future. Without imputing any fraudulent intention, it is safe to say that such estimates usually prove too sanguine.

Secondly, if a bank manager has a sudden doubt of the position of the customer to whom he has granted an overdraft, he must not therefore dishonour his cheques without reasonable notice. Of course, if a limit has been agreed upon, beyond which the customer must not draw, and cheques are presented which will exceed this limit, they may be

returned unpaid without notice and without scruple. But if a banker has been in the habit of allowing his customer to overdraw to an agreed amount, he must act with caution in refusing to pay up to this amount; if he should attempt to dishonour cheques in such circumstances without what the law considers "reasonable notice," he may find himself mulcted in heavy damages.

Another similar point to remember is that a banker should not dishonour his customer's cheque solely for the reason that the debit of his quarterly or half-yearly charges for interest and commission has brought the overdraft up to or beyond the agreed limit, unless the customer has had notice of such charge. It is advisable, if the banker's charges bring the account somewhere near the limit, to send the customer his pass-book with the entries made, which in all probability will constitute notice of such charges.

CHAPTER XIX.

THE MONEY MARKET

THE Money Market is a general name for the sphere of operations of certain classes of men who wish to borrow or lend money, and is grouped around the Bank of England and those streets in the immediate neighbourhood where for centuries the City bankers have congregated.

The Money Market deals more especially in loans for very short periods. The fund which is dealt in is called the "short loan fund of the London Money Market." This short loan fund consists for the most part of the unemployed money of the banks. By "unemployed" is meant that money which is not permanently invested by the banks, but which it is thought advisable to have ready at hand. It is described in the balance sheets of the various banks as "money lent at call or on short notice."

On the one hand, we have the banks who have money to lend; on the other hand, there is a group of men who carry on their business partly by means of borrowed capital. These are the bill brokers and

the operators on the Stock Exchange. Added to these are the British Government, which borrows money from the market from time to time, and the Indian Government, which also lends money. Foreign governments and foreign banks also take advantage of London's position as a recognised monetary centre, and there is usually a very large amount of foreign capital invested in the London Money Market.

London occupies quite a peculiar financial position compared with the other capitals of Europe. The Bank of England is compelled by its charter, as we saw in a previous chapter, to buy all gold offered to it, and before 1914 it never attempted to place any obstacle in the way of those who wished to export gold, except by raising the rate of interest. In this way London acquired the reputation of being the only perfectly free market for gold. There were, it is true, other free gold markets, but their stock of gold was not of sufficient size to raise them to a position of international importance.

Of course the Bank of England is intimately connected with the Money Market; in fact it is the pivot of the Market, but the Bank is generally spoken of as apart from the Market, whose interests are, as we shall see later, often antagonistic to those of the Bank.

The position of the bill brokers demands a few words of explanation. In most, if not all, of the European capitals the business of bill discounting is carried on by the banks, but in London there is a class of middlemen between the banker and the holders of bills. These are the bill brokers, who

have acquired a great part of the business of discounting bills in London. It should, however, be noted that the bill-broker takes his commercial bills from the Money Market, *i.e.* those foreign and overseas banks who are in the habit of re-discounting their bills, and such financial houses as are known in the Market. He does not discount for the general public, and the retail trader or other person wishing to discount small amounts of bills goes to his banker, not to a bill-broker. Since the War, a large part of the port-folio of the bill-broker consists of Treasury Bills, which are short-dated obligations of the British Government, usually maturing at 3 months from the date of issue, in which form a substantial part of the country's unfunded debt is held. Much of the bill-broker's business is conducted with money borrowed from the banks, either in the form of seven-day loans or day-to-day money, or even such short loans as "over-night" money, lent from one afternoon to the next morning.

Two things are of especial interest to all who study the Money Market; these are, the Bank of England Reserve of coin and bullion, and the Rates of Interest prevailing in the Market. Owing to the unique position occupied by the Bank of England in our banking system—a position which has been explained in a former chapter—the Reserve of the Bank of England has come to be regarded as the national reserve. All of the London Clearing bankers are compelled to keep an account at the Bank of England, and as the other bankers all appoint London agents with whom they keep a balance and upon whom they draw, it follows that the

Bank of England is open to be drawn upon directly or indirectly by the whole of the English banks. With the exception of the balances kept at the Bank of England or the London agent, few banks keep a legal tender reserve of any great extent beyond the money which is held as still money, and required for day-to-day purposes. It is easy to see, therefore, the importance which attaches to the Bank of England Reserve.

During the eighteenth century, if gold was being drained from the country, and the Bank of England's reserve was abnormally diminished, the remedy was found in a contraction of the paper currency, which caused gold to flow into the country to fill the vacancy so caused. But from the passing of the Act of 1844 until 1914 the note circulation varied automatically with the influx and efflux of gold to and from the Bank of England. Another method has during the past century come into use to attract gold to the country—a method much more certain and rapid in its action; that is, the raising of the prevailing rates of interest in the Money Market. If the general level of interest in the Market rises, the prospect of increased profit induces foreigners to remit money to the London Market and to buy bills on London, both of which tend to make the foreign exchanges more favourable to this country, and so bring about an import of gold from other financial centres. At the same time the increased borrowing rates, by lessening the demand for loans for business and speculative purposes, tend to check expenditure and so to reduce prices in this country, with the result that imports are discouraged and exports encouraged.

It can now be seen why the Bank of England is often antagonistic to the Money Market. The Market, that is to say, the borrowing portion of the Market, is always anxious to keep the rate of interest low. "Cheap money," that is, money which can be borrowed at a low rate of interest, is a necessity to those classes which trade in part with borrowed capital. The Bank of England, on the other hand, is often compelled to use every effort to force up the prevailing rates of interest against the inclination of the Market. The Bank of England cannot altogether control these prevailing rates, but it is able to influence them powerfully through its own official rate of discount, commonly called the Bank Rate.

There is consequently a see-saw tendency in the Money Market—one set of forces at work endeavouring to raise the rate of interest in order to protect the Reserve, another set of forces working to lower rates in order to obtain cheap loanable capital; and this forms the chief point of interest to those who are concerned with Money Market operations. The balance is maintained by the large London banks whose surplus funds are employed in the Market.

Let us see for a moment what are the various rates of interest prevailing in London.

First, there is the Bank Rate—that is, the advertised minimum rate at which the Bank of England will discount bills. This rate is fixed by the Bank Court at their weekly meeting each Thursday, though in times of emergency alterations are made at other times.

Secondly, there is the Bank of England Loan

Rate, usually a trifle higher than their Discount Rate.

Thirdly, there is the Market Rate of Discount, that is to say, the rate charged by the bill brokers and bankers for discounting bills. There are usually two quotations of this rate—the lower one for first-class bills, that is to say, bills drawn upon bankers and certain other houses of well-known standing in the City; the higher rate for the better class of trade bills.

Fourthly, there is the Clearing Banks' London Deposit Rate. The Bank of England does not allow interest on money deposited with it, but the Clearing Banks allow a rate which bears a fixed relation to Bank Rate, usually 2 per cent. below.

The bill-broking houses also allow interest on deposits, usually slightly higher than the Other Bankers' Rate.

Fifthly, there is the Bankers' Call Rate and Seven-Day Rate, that is, the rates charged for lending money to the bill brokers and others. Besides these five rates, there is the rate of interest charged by banks to their customers for loans or overdrafts. This is not strictly a Money Market rate, but it usually bears a relation to Bank Rate.

All these rates of interest are related to and dependent upon one another.

Take the first and third, the Bank of England official rate of discount and the market rate of discount. As a general rule the latter is slightly lower than the Bank rate. The bill brokers have no responsibility in the shape of a Reserve to hamper them, and can afford to discount at a

fractionally lower rate, though it must be noted that the Bank of England will usually discount for regular customers at the market rate, in spite of the fact that its own published rate is higher.

We will suppose that the Bank of England, which is usually well informed as to the probable trend of events at home or abroad, thinks it advisable to raise the rate of discount. It is not sufficient if it merely raises its own rate of discount; it must carry the market rate with it, or the only result will be that it will get no bills offered to it, and its rate will be merely nominal.

The result of raising the Bank Rate will be that the Clearing Banks will raise the rate which they allow on deposits. This will compel them, or at least will offer them a strong inducement, to raise the rate which they charge the bill brokers for money lent at call and short notice, otherwise their rate of profit will be seriously diminished. But if the bill brokers have to pay more for their borrowed capital, they will be forced, in self-defence, to raise the discount rate which they charge the public. Thus it will be seen the rise in the Bank Rate has brought about a rise in the Market Rate of discount.

There is another method in which the Bank of England is enabled to influence powerfully the ruling rates of interest. The amount of money which the banks are disposed to lend to the market at any particular period is a limited amount, and if it should prove insufficient, the only recourse of the bill brokers is to borrow from the Bank of England, which, since it has the monopoly of the note issue

and the custody of a large reserve, is usually disposed to lend, if necessary, but of course at its own rate.

Speaking generally, the Market will not borrow from the Bank of England if it can get the money elsewhere, not only because the terms which the Bank gives are less favourable than those of the other banks, but also because the Bank is not so accommodating as regards the period of the loan. But if they cannot borrow the money from the other banks, the bill brokers must go to the Bank of England, and this gives the latter the opportunity of raising the market rate, because the bill brokers have to pay a higher rate on their borrowed capital, and must therefore charge their customers higher. This is the meaning of the phrase which sometimes occurs in the daily money article in the morning paper, somewhat as follows: "A considerable amount being locked up in the instalments of the X. loan, the Market was driven to the Bank."

If the volume of loanable funds is so large that the Bank of England is unable to make its own rate effective, it can reduce the amount of such funds by selling securities. Payment for such sales is made by cheques which diminish the balances kept at the Bank of England by the banks on which they are drawn. Similarly, the Bank can, if necessary, provide the Market with increased funds, or, to use a familiar phrase, increase the volume of "bank cash," by purchasing securities, payment for which increases the balances of the other banks.

As a rule, the greater the stringency in the Money Market, the greater the power of the Bank of England. At times when the financial horizon is clear and money is cheap and plentiful, the influence of the Bank of England is small, but if the outlook becomes really threatening, the Bank obtains practical control of the market.

The amount of money available for lending in the Money Market depends upon a variety of circumstances which cannot be accurately gauged. Trade conditions, the political outlook, especially the prospect of peace or war, the state of the foreign exchanges, the condition of credit—that is to say, whether there is general confidence in the financial outlook, or whether distrust is more prevalent—all these things affect the short loan fund of the Money Market. If trade be brisk and more money be required for commercial undertakings, there will usually be less to lend on the Market. Conversely, in periods of trade depression, money is usually plentiful and cheap in the Money Market, because there are few openings for its profitable employment in other directions. War always has the effect of "hardening" rates, in other words, of raising the rate of interest, because it is always anticipated that a war will lock up large sums of money in the shape of war loans. During the post-war period Government finance overshadowed all other factors affecting the volume of the short loan fund to such an extent that the rate offered by the Government when borrowing for short periods materially influenced the general level of interest rates.

But besides these general causes, which are un-

certain and often unexpected, there are certain special recurrent forces at work whose action is known and looked for each year.

First of all, money is always more plentiful at periods when the Government dividends are paid. At these periods, money is liberated from the Government accounts at the Bank of England, and finds its way to the deposits of the Other Banks. The warrants are sent to the proprietors, who pay them into their banking accounts, and so increase the balances of the joint stock and private banks, which are enabled to lend more freely.

Secondly, during the first three months of the year money is generally scarcer in the Market owing to the payment of taxes. The payments on account of Income Tax and other taxes, transfer money from the Other Banks to the Government accounts at the Bank of England, and, as we saw just now, the Market will not borrow from the latter if it can avoid doing so. The Other Banks have less to lend, and the Market is more dependent on the Bank of England.

Thirdly, experience shows that trade is usually brisker in the autumn of the year, and that there is not only more demand for borrowed capital, but also for legal tender, which reduces the Bank Reserve and so tends to harden rates. What is called the "autumn drain" is anticipated each year, and can be explained in various ways. We have to pay for our imports of cotton and corn from North America at this season, besides paying for our own harvest. Money which is sent down into the country to pay for agricultural operations does not so easily

find its way back to the London Money Market as money sent by cheque to pay the usual business debt; the latter soon returns to London through the medium of the Clearing House.

CHAPTER XX.

THE BANK RETURN.

THE weekly return of assets and liabilities issued by the Bank of England which appears in each Friday morning's paper has a significance far above that of the balance sheets of any other bank. The Bank Return is the barometer of the Money Market. It enables the financial man to forecast the probable "dearness" or "cheapness" of money, not always with exactitude, for, like all barometers, its accuracy is not always unimpeachable, but with approximate correctness.

Subjoined is the Return for the week ended August 12th, 1936:—

BANK OF ENGLAND.

An account for the week ended on Wednesday, the 12th day of August, 1936.

Issue Department.

	£		£
Notes issued:		Government debt	11,015,100
In circulation -	450,284,889	Other Government securities -	246,314,524
In banking department -	52,675,538	Other securities -	2,137,347
		Silver coin -	533,029
		Amount of fiduciary issue -	260,000,000
		Gold coin and bullion - -	242,960,427
	£502,960,427		£502,960,427

Banking Department.

	£		£
Proprietors' capital - - -	14,553,000	Government securities - -	89,613,310
Rest - - -	3,627,191	Other securities :	
Public deposits (including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts) -	17,418,402	Discounts and advances -	8,938,854
Other deposits :		Securities -	19,290,476
Bankers -	97,989,881	Notes - -	52,675,538
Other accounts	37,980,525	Gold and silver coin - -	1,050,821
	£171,568,999		£171,568,999

H. B. C. YEOMANS,
Dated the 13th day of August, 1936. *Deputy Chief Cashier.*

It will be noticed that the Return is divided into two parts, the Issue Department and the Banking Department, according to the terms of the Act of 1844. It is an arrangement peculiar to the Bank of England, and has been copied by none of the Continental State Banks.

The sole function of the Issue Department is to issue notes; of the total of £502,960,427 in the Return before us, £260,000,000 is issued against securities, the "fiduciary issue" as it is called; of these "securities" £533,029 consists of silver coin, and £11,015,100 is the debt due to the Bank by the Government, money lent to the State from time to time in return for the privileges of "exclusive banking," which were granted to the Governor and Company. This amount has not been increased since 1833. The

notes in excess of the fiduciary issue are covered by gold coin and gold bullion amounting to £242,960,427. The Cunliffe Committee, in their Interim Report published at the end of the year 1918, written in contemplation of a return to a gold standard, recommended that in the first instance "the normal minimum amount of the central gold reserve should be £150,000,000," but that this amount should be open to revision in the light of subsequent experience.

It will be seen that the total of the notes issued is divided between notes in circulation and notes held in the Banking Department. The Issue Department is compelled to issue notes to every one offering gold, at the rate of £3 17*s.* 9*d.* per ounce of standard gold. Those notes not required by the public are transferred to the Banking Department and form part of the Bank Reserve.

The asset in the Issue Department, "£242,960,427, gold coin and bullion," comprises practically the whole stock of gold in the Bank, unless there is an undisclosed portion of the assets of the Exchange Equalisation Account held in gold at the Bank of England, a point upon which no information is vouchsafed to us. A certain amount of gold and silver coin is kept in the Banking Department and at the branches for immediate use, but beyond this amount, generally less than a million, all gold is transferred to the Issue Department.

It should be understood, after what was said in the chapter on the Bank Act, that, except with the consent of the Treasury, the above total of the notes issued, £502,960,427, can only be increased by adding a corresponding amount to the gold on the asset side,

and that this gold can only be withdrawn from the Issue Department by cancelling a corresponding amount of notes, either by transferring them from the Reserve in the Banking Department, or withdrawing them from active circulation.

Of the total of notes in circulation, £450,284,889, an unknown but doubtless substantial portion is at the present time held by foreigners who have lost confidence in the currencies of their own countries, and therefore does not in the strict sense form part of the circulation of this country.

To turn now to the Banking Department, the first liability is Proprietors' Capital, £14,553,000. The amount of the capital stock was originally £1,200,000, but it has remained unchanged at its present total since 1833, and it will be observed that, compared with the paid-up capital of the leading joint stock banks, its relation to the Bank's liabilities to the public is high. This, of course, adds to the security of the Bank, but it forbids the payment of a high rate of dividend, and the usual 11 or 12 per cent. paid by the Bank is, considering its age and reputation, and also the fact that it pays no interest on its deposits, a very modest one.

The next item, Rest, £3,627,191, is the amount of the undivided profits of the Bank, and in most bank balance sheets would take the form of a Reserve Fund and Profit and Loss Account. Most banks separate these two accounts, but the Bank of England combines them in one. As, however, it is the practice of the Bank of England never to reduce the Rest below three millions, this sum practically

represents its Reserve Fund, and the surplus over £3,000,000 is the Profit and Loss account available for dividend purposes, so that it is possible to forecast the probable dividend of the Bank with some degree of accuracy by a study of the amount of the Rest.

The Public Deposits are explained in the Return; they are the balances standing to the credit of the various Government Accounts. The Other Deposits include not only the deposits of the Bank's ordinary customers, but also of the joint-stock and private banks which keep accounts at the Bank, including all the Clearing Bankers, each of which is, by the rules of the Clearing House, compelled to keep an account at the Bank of England. At one time the Bankers' balances were published separately in an annual return, but the practice was discontinued in 1877 and their publication only resumed in November, 1928. The Bankers' balances naturally afford the best criterion of the amount of money available for lending to the Market.

Speaking generally, the Public Deposits and the Other Deposits in normal times vary inversely. When the Public Deposits are abnormally high, Other Deposits are usually low, and *vice versa*. The reason is that when large amounts are paid to the Government credit, as, for instance, when, during February and March, arrears of taxes are paid and the Government is preparing for the close of its financial year, or at times when instalments of a Government loan are payable, such amounts are paid to a very great extent by cheques on Other Banks, which, of course, reduce the Bankers' balances. On the other hand, when the Government pays the dividends on the government stocks, large sums are liberated from the

Public Deposits and find their way to the deposits of the Other Banks.

In normal times a high total of "other deposits" is usually coincident with cheap money and plenty of loanable capital. For instance, in 1890, when the average Bank rate was as high as £4 10*s*. 5*d*. per cent., the average of the Other Deposits was £27,526,000. But in 1896, when the average of the Other Deposits was £49,390,000, the Bank Rate only averaged £2 9*s*. 8*d*. (*a*).

In some circumstances, however, such as those which point to an impending monetary crisis, or any serious disturbance of the Money Market, the Other Deposits rise rapidly at the same time that the Bank Rate rises. The reason for this is that when anything threatens the peace of the Money Market, the London banks prepare for the worst and endeavour to strengthen their position. In order to do this they call in their loans to the Market and increase the amount of their balances at the Bank of England, which can be drawn upon at a moment's notice. In the crisis of 1857, when the Bank Act had to be suspended, the Bankers' balances stood on November 4th, at the beginning of the crisis, at £3,400,000. By November 25th they had risen to £5,400,000, an increase of £2,000,000. In 1890, the year of the Baring crisis, we have not the figures of the Bankers' balances, but the Other Deposits show a no less marked rise, from £29,171,968 on November 6th to £36,364,838 on November 20th. In both of these instances there is not the slightest doubt that the rise was due to the action of the bankers

(*a*) Palgrave. Bank Rate and the Money Market, pp. 12–15.

in calling in their short loans so as to strengthen their position in view of the impending crisis.

In 1914 we find that Other Deposits rose from £42,185,000 on July 22nd to £54,419,000 on July 29th. After the outbreak of war their amount increased to £108,094,000 on August 19th and £133,819,000 on September 2nd. The increase before the outbreak of war is probably due to the same causes as was outlined above, but after the extended bank holidays the calling in of loans ceased and the increase is due to other causes.

The first item upon the asset side is Government Securities, £89,613,310. The Bank does not give the public any information about the details of the securities in which it invests its money, beyond that given in the Return. The total includes the Bank's investments in British Government stocks and Treasury Bills; it also includes what are called "deficiency bills," and "ways and means advances," which are different forms of temporary advances to Government. Since the year 1928 "Other Securities" have been divided into two categories, the one consisting of discounts and advances amounting on August 12th to £8,938,854, the other, £19,290,476, being presumably the remainder of the Bank's investments.

It will be noticed that the term "securities" as used in the Bank Return has a wider application than that which it usually receives among bankers. It includes, besides the Bank's own investments, the debts due to the Bank from those to whom the Bank has lent money. The term is more often used to denote the collateral security held against such loans. Any advance made by the Bank will therefore increase the amount of either Government Securities or Other Securities.

We have no means of learning the details of the Bank's holdings of bills, but it is generally understood that it does not buy foreign bills, that is, bills accepted payable abroad, and that it requires at least two British names on bills offered for discount, one of which must be the acceptor's. Many of the Continental State Banks, however, habitually invest part of their assets in bills maturing at some other financial centre, for in case of emergency this gives them the power of acquiring gold by discounting the bills in the place where they mature.

Reference was made in the last chapter to the meaning of the phrase that the Market was "in the Bank," that is, that it was driven to borrow money from the Bank of England. When this happens it often shows itself in the Other Securities and Other Deposits. If the Other Bankers either refuse to lend or call in a proportion of the loans they have already made, the total of the Other Deposits will rise owing to the increase in the bankers' balances. The Market being driven to the Bank, the Discounts and Advances will rise, so that a simultaneous rise in Other Deposits and Other Securities is often evidence of a desire on the part of the Other Bankers to strengthen their position.

The last two items on the asset side, notes £52,675,538 and gold and silver coin £1,050,821, form the Reserve of the Bank, the reserve on which, so long as we were on a gold standard, our whole banking and financial system may be said to have rested. The total liabilities of the Banking Department, exclusive of those due to the proprietors of the Bank, were £153,388,808, so that the Reserve on the date in question was 35 per cent. of the liabilities to the

public. The notes which form part of the Reserve are the surplus not required by the public; they are represented by gold in the Issue Department, and should gold be required, as, for instance, for export purposes, the notes can be cancelled and gold withdrawn from the Issue Department, so long as the notes in active circulation do not fall below the limit of the fiduciary issue, viz., £260,000,000, which is not likely to happen. Consequently there is always more than sufficient gold in the Issue Department to pay all the notes held in the Reserve of the Banking Department. Should the demand for gold ever prove so great that the Reserve is exhausted, there is an ultimate reserve of gold in the Issue Department which can be used by taking advantage of the power given to the Bank to apply to the Treasury for a temporary increase in the amount of the fiduciary issue. Such an application was made on August 1st, 1931, and power granted to the Bank to increase its fiduciary issue by £15,000,000 in excess of the statutory limit of £260,000,000.

CHAPTER XXI.

THE FOREIGN EXCHANGES.—I.

THE subject of the Foreign Exchanges is to the average man a complex one, and it is one which cannot be adequately treated within the limits at the author's disposal, but this chapter will help the student to understand the frequent allusions to the subject which constantly occur in most treatises on banking. The foreign exchanges are the index of the international value of money, the value in one country of a debt payable in another, and of the conditions governing the transmission and settlement of such debts. It is obvious that to a man living in London ten sovereigns in India will not be worth so much as ten sovereigns in London. The cost of sending the sovereigns from India to London will detract from their value. Or, supposing a man living in New York owes a man living in London £100, and that by the terms of the contract the debt is payable in New York. In whatever way the debt is collected, the sum realised in England will be somewhat less than £100. In fixing a rate of exchange, besides the question of the cost of transmission, there is also the question of an equation between the two systems of coinage which are in

use in the two countries, unless the systems happen to be the same, as, for instance, in England and Australia. In some cases a relation has to be established between the amount of pure metal contained in the standard coins of the various countries. This relation is called the Mint Par of Exchange. When we say that the Mint Par of Exchange between London and New York is 4·8665, we mean that the value of the metal in one full-weight sovereign equals 4·8665 golden dollars, apart from any idea of distance and supposing the coins to be in the same place.

It follows that there can only be a Mint Par of Exchange between countries which use the same metal as their standard of value. There is no Mint Par between a gold-using country and one in which silver is the standard of value, because the exchange value of silver to gold is constantly changing. Similarly, if one of two countries uses a paper standard of value there can be no Mint Par of Exchange between them. If it is quoted, it is only a fictitious rate based on the assumption that a metallic standard still exists. The Mint Par between two gold-using countries or two silver-using countries is a fixed quantity, and can only be varied by an alteration in the coinage regulations of either country.

The Mint Par of Exchange is a merely nominal rate of exchange. Owing to the various influences which affect the current rates, the Mint Par is never the existing rate, or, if it is so, it is merely a coincidence. But from the Mint Par what are called the Specie Points are deduced, and these form the limits beyond which the rate of exchange between any two countries does not often vary, if their currencies are

both based on gold. The Specie Points are determined by the cost of transmitting gold between the two countries. Speaking generally, a debtor will not remit gold if he can settle the debt in any other way; it is the most expensive way. But if other methods fail or become too expensive, and if gold can be obtained, the cost of shipping and insuring gold determines the limits outside which the rates of exchange seldom vary.

In theory the exchange rates cannot vary outside the Specie Points either way, because no one will pay more for a bill than it would cost to send gold, and directly the exchanges touch either of these limits, a movement of gold between the two countries should follow. In practice, however, this is not always the case, even when gold can be obtained, and the rate sometimes does rise or fall beyond the usually accepted Specie Points.

There are two reasons for this: First, the published Specie Points are not exact, because the cost of shipping bullion varies from time to time. During the War, for instance, the cost of, and risk and delay in transporting bullion were so great, that the Specie Points were far wider than in normal circumstances. Secondly, gold cannot always be obtained for export even in centres where there is nominally a free market.

It must not, however, be imagined that even in the most favourable circumstances gold is used for the settlement of any considerable proportion of the debts due between different countries. Even if gold is in free circulation in both countries and there are no restrictions upon its export, gold is only used to settle the balance of indebtedness which cannot

be paid by the more usual methods. As we have seen in a former chapter, an outward flow of gold is always regarded as a danger signal denoting, if continued over anything but a short period, that a country is probably living beyond its means. The principal part of the international currency consists of bills of exchange, including in this term cheques, banker's drafts, and telegraphic transfers.

Bills drawn upon and payable in London have long been an international currency. It is obviously advantageous to the commercial world that some centre should be chosen by mutual consent where bills can be made payable, and where debts can be settled. In mediæval times, bills were exchanged at certain of the great annual fairs. In modern times London has been chosen as this centre, and "sterling bills," that is, bills drawn in sterling on London, have found a ready market in all parts of the globe. This is the meaning of the phrase that London is the financial centre of the world. The growth of a nationalistic spirit throughout the world, accompanied as it has been by a remarkable decline in the volume of international trade and an almost complete cessation of international lending, has in recent years obscured the position which London held throughout the second half of last century. The bill of exchange has ceased to play the part it once played in international affairs, and London's purse is, for a time at all events, no longer at the disposal of the world's borrowers.

In London's foreign exchange market foreign currencies are bought and sold, and, as in many other of London's markets, there are both dealers and brokers. The former are the banks and the latter are inter-

mediaries who put the buyers and sellers among the dealers in touch with one another. The brokers do not deal but obtain their remuneration in the shape of a commission on their turn-over. Dealers and brokers are in constant touch with one another by telephone, and transactions are carried out at a speed and with a smoothness which is a source of wonder to the uninitiated.

As in other markets, the cost of foreign currencies is determined by supply and demand. If there is an unusual demand in London for francs, holders of sterling will find they have to pay more for them, and, *vice versa,* if francs are freely offered for sale, they will become cheaper.

In the days before the War, when the more financially respectable countries of Europe were on the gold standard, international debtors and creditors were content to settle their indebtedness by bills of exchange. Both parties were reasonably certain that the value of the bill at maturity would not be greatly different from its value at the date the bill was drawn. Any such certainty is now almost entirely lacking, and, as a result, " forward " purchases and sales have become a feature of modern foreign exchange work. A " spot " dealing is a purchase and sale of foreign currency for immediate delivery. A " forward " operation is a purchase and sale for delivery at or within an agreed future time, the rate being fixed at the time the bargain is made for payment at delivery. In some quarters there is still a belief that forward exchange dealings are a form of speculation or gamble. On the contrary, forward dealings, like other forms of dealing in " futures," are an invention designed to enable the

business man to insure against the risks of a fluctuating exchange. If he sells goods for which he is to receive payment in francs three months after delivery, he will be reluctant to run the risk that his expected profits will vanish owing to a drop in the value of his francs. His banker therefore steps in and buys the francs "forward." Speculators are of course attracted to a market which offers the chance of a reward to the skilful or lucky operator, but the big banks do not speculate. If they sell forward they take good care that the foreign currency shall be available and cover themselves by a reverse operation, and their only risk is usually the failure of one of the parties to carry out their bargain, or possibly the action of a foreign government in "blocking" the balances standing to their credit in the foreign centre.

The following table of rates quoted in London is taken from *The Times* for October 20th, 1936. It shows the range within which business was transacted on the previous day. Bank rates are indicated by the figures given in parentheses following the place names. The rates are for telegraphic transfers where not otherwise indicated.

Place	%	Method of Quoting	Par of Exch'ge before Sept. 30, 1931	Oct. 19th
New York	($1\frac{1}{2}$)	\$ to £	$4.86\frac{2}{3}$	$4.88\frac{1}{4}$—89
Montreal	.	\$ to £	$4.86\frac{2}{3}$	4.88—89
Paris	(2)	Francs to £	124.21	$104\frac{29}{32}$—$5\frac{1}{32}$
Brussels	(2)	Belgas to £	35.00	29.02—29.08
Milan	($4\frac{1}{2}$)	Lire to £	92.46	$92\frac{3}{4}$—93
Switzerland	(2)	Francs to £	25.22	21.26—21.30
Athens	(7)	Drachmas to £	375.00	540—560

Place	%	Method of Quoting	Par of Exch'ge before Sept. 20, 1931	Oct. 19th
Helsingfors	(4)	Finnish marks to £	193.23	$226\frac{1}{2}$—$227\frac{1}{4}$
Madrid	(5)	Pesetas to £	25.22	nominal
Lisbon	($4\frac{1}{2}$)	Escudos to £	110.00	110—$110\frac{3}{8}$
Amsterdam	($2\frac{1}{2}$)	Florins to £	12.11	9.04—9.12
Berlin	(4)	Marks to £	20.43	12.12—17(*a*)
Vienna	($3\frac{1}{2}$)	Schillings to £	34.59	$25\frac{1}{2}$—$27\frac{1}{2}$
Budapest	(4)	Pengos to £	27.82	26—28 (*f*)
Prague	(3)	Korony to £	164.25	$137\frac{3}{4}$—$138\frac{3}{8}$
Danzig	(5)	Gulden to £	25.00	$25\frac{3}{4}$—$26\frac{3}{4}$
Warsaw	(5)	Zloty to £	43.38	$25\frac{3}{4}$—$26\frac{3}{4}$
Riga	(6)	Lats to £	25.22	$24\frac{3}{4}$—$25\frac{3}{4}$
Bucharest	($4\frac{1}{2}$)	Lei to £	813.60	660—680
Constantinople		£T to £	—	6.12 †
Belgrade	(5)	Dinars to £	276.32	209—219
Kovno	(6)	Litas to £	48.66	$28\frac{3}{4}$—$29\frac{3}{4}$
Sofia	(6)	Levas to £	673.66	390—420
Tallinn	(5)	Kroons to £	18.16	$17\frac{3}{4}$—$18\frac{3}{4}$
Oslo	($3\frac{1}{2}$)	Kroner to £	18.16	19.85—19.95
Stockholm	($2\frac{1}{2}$)	Kroner to £	18.16	19.35—19.45
Copenhagen	($3\frac{1}{2}$)	Kroner to £	18.16	22.35—22.45
Alexandria		Piastres to £	97.50	$97\frac{3}{8}$—$97\frac{5}{8}$
Bombay	(3)	Per rupee	1*s.* 6*d.*	$1/6\frac{3}{32}$—$\frac{5}{32}$
Calcutta	(3)	Per rupee	1*s.* 6*d.*	$1/6\frac{3}{32}$—$\frac{5}{32}$
Madras	(3)	Per rupee	1*s.* 6*d.*	$1/6\frac{3}{32}$—$\frac{5}{32}$
Hongkong		Per dollar	—	$1/2\frac{3}{4}$—$\frac{15}{16}$
Kobe	(3.285)	Per yen	24.58*d.*	1/2—$1/2\frac{1}{16}$
Shanghai		Per dollar	—	$1/2\frac{5}{16}$—$\frac{9}{16}$
Singapore		Per dollar	2*s.* 4*d.*	$2/4\frac{1}{16}$—$\frac{1}{4}$
Batavia	(4)	Florins to £	12.11	9.02—9.08
Rio de Janeiro		Per milreis	5.90*d.*	$2\frac{27}{32}$—$\frac{29}{32}$*d* (*d*)
Buenos Aires		Paper Pesos to £	11.45	17.50—17.60(*b*)
Valparaiso *		Pesos to £	40.00	$131\frac{1}{2}$ nom. (*e*)
Montevideo		Per peso	4*s.* 3*d.*	$25\frac{1}{4}$—$25\frac{3}{4}$*d.* (*c*)
Lima *	($6\frac{1}{2}$)	Soles to £	17.38	20.00—20.50
Mexico		Pesos to £	9.76	17.50—18.50
Manila		Per peso	24.66*d.*	$2/0\frac{1}{4}$—$2/0\frac{5}{8}$

* 90 days. † Sellers.

(*a*) Registered marks are quoted at a discount of 47–52 per cent.

(*b*) The official rate is 15p., sellers, and the average remittance rate for importers, 17.00p.

(*c*) The official rate is $39\frac{7}{8}$*d.*, sellers.

(*d*) The official rate is $4\frac{1}{4}$*d.*, sellers.

(*e*) Latest "export" rate.

(*f*) The official rate is $16\frac{1}{2}$p., sellers.

P

EMPIRE EXCHANGE RATES.

The following rates are for 100 London pounds :—

BUYING RATES.

—	Demand			30 days' sight			60 days' sight			90 days' sight		
	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*
Australia .	126	7	6	126	17	6	127	7	6	127	17	6
N. Zealand † .	125	10	0	126	0	0	126	10	0	127	0	0
Do. ‡ . .	125	7	6	125	17	6	126	7	6	126	17	6

SELLING RATES.

—	T.T.'s			Demand		
	£	*s.*	*d.*	£	*s.*	*d.*
Australia	125	0	0	125	1	3
New Zealand	124	0	0	124	1	3
—	Closing Rates					
	Buying			Selling		
	£	*s.*	*d.*	£	*s.*	*d.*
S.A. Union Territory (T.T's) .	100	17	6	100	2	6
Do. (sight drafts) . . .	101	7	6	100	2	6
Rhodesia (T.T.'s) . . .	100	5	0	99	15	0
Do. (sight drafts) . . .	100	17	6	99	15	0

† Ordinary mail rates.
‡ Direct air mail rates, plus postage.

Perhaps the greatest difficulty in understanding allusions to a Course of Exchange lies in the different meanings attached to the terms "rise" and "fall." This difference arises from the fact that London quotes some rates in sterling and others in the coinage of the place quoted. Thus a rise in the nominal rate of the former class means that the man who wishes to buy foreign currency will have to pay more for it, while a rise in the rate of the latter class has the reverse meaning. For instance, a rise in the Paris rate

of exchange quoted on the London Exchange means that the same sum of English money will purchase an increased amount of French francs. On the other hand, a rise in the Calcutta rate means that the English remitter will have to pay a greater sterling amount for the same amount of rupees.

Remember, therefore, that the terms rise or fall of the exchanges refer simply to the nominal amount of the rate quoted, and may mean either a more favourable or less favourable rate for the buyer of the foreign currency.

The terms favourable or unfavourable apply to the debtor, that is, the buyer of the foreign money. When the exchanges with any particular centre are said to be favourable to this country, the rate is tending towards that point when gold would be imported if there were a free gold market in the foreign centre. Conversely, the rate is unfavourable to this country when it tends towards the other specie point, when gold would be exported if it were obtainable.

When the rates are quoted in foreign money to the pound sterling, *high* rates are *favourable* to this country; *low* rates *unfavourable.*

When the rates are quoted in shillings and pence to the foreign units *high rates* are *unfavourable, low* rates are *favourable.*

In the London Course of Exchange which used to be published before the year 1921 there were, in the case of some of the more important centres, a " sight " or cheque rate and a three months' or " long " rate. The long rate is not now usually quoted, but, given the short exchange with any centre and the market rates of discount prevailing *in that centre,* the

long rate can be calculated with approximate certainty.

The long rate is the rate at which a certain sum will buy a bill to realise the same amount as the cheque or telegraphic transfer which can be bought for that sum at the short rate, allowance being made for the fact that the bill will be subject to a charge for discount and for bill stamps, if the man to whom it is sent wishes to realise it at once. In the case of rates quoted in terms of the foreign unit the long rate quoted in London on the foreign centre will be higher than the short rate, as the purchaser will expect to get more, say, francs for his £ if he has to wait three months for payment. Similarly the long rate quoted in Paris on London will be lower than the short rate.

Bills are sometimes dealt in which are neither sight bills nor at "usance," *i.e.* the customary period at which long bills are quoted between any two given centres. They have, let us say, thirty or forty days to run before maturity. In these cases a rate called a "tel quel," or "t.q." rate, is calculated from the long rate to fit the bill in question.

For the student who finds any difficulty in grasping the effect of a rise or fall in the rates upon the value of a foreign bill, the maxim quoted by Mr. George Clare (*a*) in his excellent work on the Foreign Exchanges, will be found extremely useful:

"Buy high, sell low; the better the bill, the lower the rate."

A word of caution must, however, be added. This

(*a*) The A. B. C. of Foreign Exchanges, G. Clare, p. 51.

maxim only applies to those rates which are quoted in foreign units to the £1 sterling.

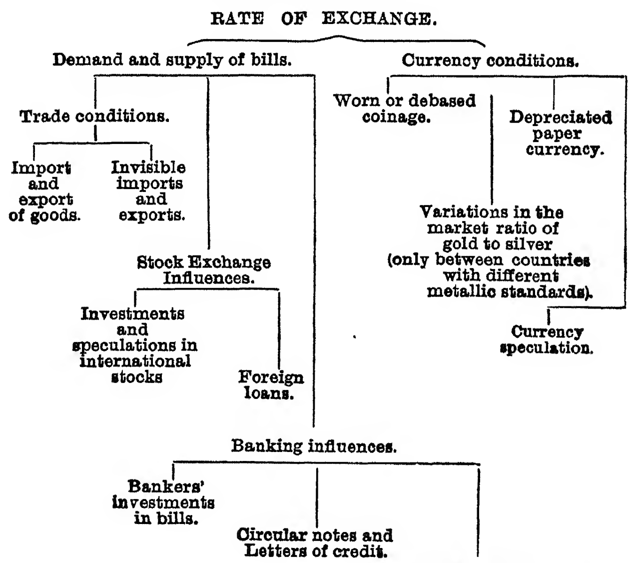
In dealing with the currencies of countries which London quotes in shillings and pence to the foreign unit, the exact reverse of this is true, and the rule to be remembered is the usual commercial rule for buying and selling commodities: "Buy low, sell high; the better the bill the higher the rate."

CHAPTER XXII.

THE FOREIGN EXCHANGES.—II.

FLUCTUATIONS in the rates of exchange are the result of two sets of causes: (1) those dependent upon the demand for and supply of bills (including cheques and mail and telegraphic transfers); (2) those dependent upon the condition of the currency of the countries concerned.

The following diagram is intended to show the nature of these sets of causes.



It must be borne in mind that the rate of exchange is not dependent upon the indebtedness of the countries concerned. It is the debts which are in process of being paid which affect the exchanges, but the total indebtedness of either country may not affect the exchanges in any way. Most nations are indebted to England owing to the investment of English capital abroad, and though, as we shall see, the payment of the interest on such investments has an important bearing on the rate of exchange, yet the capital sums do not affect the rates except at the time they are borrowed or repaid.

Turning to the trade conditions upon which depend the demand and supply of foreign currency, abnormal imports tend to turn the exchanges against a country, and abnormal exports tend the reverse way. Take the New York Exchange, for instance. In the autumn of each year we import large amounts of food-stuffs and cotton from the United States, and therefore the price of sterling falls in New York, and the rate of exchange is usually unfavourable to this country.

It is not, however, safe to expect that the trade conditions between this country and another will always act upon the rate of exchange with that particular country; it may affect exchange rates in quite a different quarter. Suppose, for instance,

Germany is buying coal or other raw materials in this country and that she possesses balances in banks in, say, Switzerland. It is possible she may draw upon those balances to pay for her imports from Great Britain. In such a case the visible effect would be that the rate of exchange between Switzerland and London would become more favourable to London, but the rate between Germany and London would not necessarily be affected.

Under the second head of trade conditions affecting the rate of exchange we have what are called "invisible exports and imports." This is an expression used to include services rendered by one nation to another which have to be paid for, and which, therefore, exert just the same influence on the exchanges of the country which renders the service as would an export of goods by that country. The freight earned by our carrying fleet is an important item in our exports which does not appear in the Board of Trade Returns, and the amount of which cannot be easily estimated, though, as we own roughly half the mercantile marine of the world, it is by no means inconsiderable. Brokerage and commission earned in London on business transacted for foreigners is also another important item, and we can perhaps best include under this head the earnings of British capital invested abroad.

Stock Exchange influences on the rates of exchange are divided into two heads: investments and speculations in international stocks, and the issue of foreign loans.

Paragraphs such as the following may often be observed in the daily money article: "Royal Dutch opened weak, but the receipt of heavy buying orders from Paris resulted in the price closing ½ up."

The prices of certain "international" stocks which find a ready market on all the chief European "bourses" are telegraphed continually from one financial centre to another, and variations in the prices quoted result in orders to buy or sell being sent from one centre to another. There is always an international account running between the chief investing centres. Parcels of bonds are sent from London to be sold at Wall Street and *vice versa*, and the payment of the drafts drawn to settle the accounts turn the exchanges one way or the other.

A similar effect results from loans floated in a foreign centre. Most nations who wish to float a loan open a subscription list in London, and the money so borrowed has to be remitted in some shape. Sometimes the proceeds are exported from England in the shape of goods, and so influence the

exchanges indirectly through trade channels. War indemnities have a similar effect upon the exchanges. For instance, at the end of the Chino-Japanese war, China paid a large part of the indemnity through London, where it remained a considerable time, part of the amount being remitted by us to Japan in the shape of ships and other manufactured articles, and part remitted by bills upon London.

Money is also borrowed in London for commercial undertakings abroad, and English capital is invested all over the world. Of late years, even before the war, the reverse of this has happened with respect to the United States, who have been acquiring an increasing financial interest in English undertakings, while the holdings of Englishmen in American railways and other commercial concerns are on the decline. The latter tendency has received an enormous impetus through the war.

The third group of influences which determine the price of bills on the market is classified under the head of banking influences. Chief among these are the bankers' investments in bills as a means of affecting gold movements. Certain financial centres, London, Paris, New York, and Berlin, have been known as "gold centres," because a more or less free market for gold have long existed there, as opposed

to those other centres where gold could not be obtained for export. For the time being, however, this group of influences has ceased to play the part it once assumed.

Besides the power of influencing gold movements which foreign bills possess, they afford a good investment to the banker, especially if the rate of interest rules higher in the centre upon which they are drawn than in the banker's own town. A banker can make a profit by buying "long" bills, keeping them till maturity, and then selling them at the "short" rate, or if the rate of interest in the foreign centre should fall in the meanwhile, he may make a quicker profit by selling them at once.

Among banking influences must be included finance bills of various kinds. There are regular seasons of the year when many of the staple international crops are harvested and transported, but contracts are freely entered into a considerable period in advance. In such a case, especially when rates of exchange fluctuate as violently as they have done in the past few years, the importer probably wishes to fix the amount of his liability, and one way of doing this is to buy "forward exchange" of his banker, that is, the banker contracts to provide so many dollars in New York, or milreis in Brazil, at a fixed rate on a certain date, the banker, on his part covering himself, if he is a prudent man, by arranging that on the date fixed

he shall have a balance to draw upon in the centre named.

Circular Notes and Letters of Credit also influence the rate of Exchange. They are chiefly used by travellers, and at certain seasons of the year Englishmen migrate to the continent in crowds, mostly armed with these documents, which are in effect, and usually in form, bills upon London. They consequently help to turn the exchanges against this country.

The third of the Banking influences is to be found in arbitrage operations. This is the name given to the transactions of certain banks and mercantile houses which can draw upon, or be drawn upon, by a foreign house or agent. Profits can be made by buying bills in one centre and selling them in another, if there is sufficient difference in the rates ruling at these centres. It is a form of speculation in differences. There are arbitrage transactions in bills, in bullion, in stocks and shares, but in each case the operations are similar and the profits are made through the differences in price which may exist in various centres.

So far we have discussed those influences which affect the rate of exchange through the demand and supply of bills, but exchange rates are subject to fluctuations which arise through no variations in

the number of bills offered for sale or the demand for such bills, but simply from the condition of the currency in either or both of those countries.

A depreciated currency may be due to a debased or worn coinage, to an over issue of paper, to an enforced departure from the gold standard resulting from lack of confidence in the country's financial position, or to a deliberate attempt to give exporters a trading advantage over their competitors in other countries ; any one of these will affect the nominal rate of exchange, because the rate is quoted in terms of the currency which can be legally or customarily tendered in payment of a debt, not in terms of the full weight coin, which is probably only a legal fiction and does not circulate. It has been laid down as a general rule that the rate of exchange at which two currencies are quoted represents the ratio of the purchasing power of such currencies in the countries in which they respectively circulate. This rule, however, breaks down when for any reason the currency of a country, or the Government which issues it, forfeits the confidence of the holders. The purchasing power of the German mark in Germany was, for instance, for a long time much higher compared with the purchasing power of the pound sterling in Great Britain than the rates at which they have exchanged would warrant, and the same was true of Great Britain's currency for

a time after September, 1931, the external purchasing power of the pound sterling declining by about a third while internal prices remained almost unchanged. The operation of the rule is moreover modified or prevented by the existence of trade restrictions such as tariffs, quotas and other impediments to the exchange of goods.

Finally, between countries which use a different metal as their standard, the rate is subject to the variations in the gold price of silver bullion. India, Japan and China have now adopted a gold standard, but in so far as the use of silver as a standard of value still exists, the rate of exchange with the countries using it depends upon the gold price of silver as well as upon the other factors we have considered.

CHAPTER XXIII.

THE STOCK EXCHANGE.

IT is of course impossible to give a detailed account of Stock Exchange operations within the limits of a single chapter, but a short explanation of the terms in general use may be of interest to the student.

No one is allowed to do any business on the London Stock Exchange unless he be a member, or the authorised clerk of a member. The class of men called "outside brokers" either do business through a member of the "House," or else they buy and sell shares for their customers without making use of the Stock Exchange at all.

The members of the latter are divided into two classes, stock "jobbers" or "dealers" and stock "brokers," an arrangement peculiar to this country. All orders to buy or sell securities are given by the public to a stock broker, who goes to the House and makes a bargain in the required security with a jobber. The broker makes his profit by charging a commission to the general public; the jobber makes his by quoting a double price for all securities in which he deals; the higher price is the one at which

he is willing to sell, the lower that at which he will buy. If the broker wishes to deal, he, without telling the jobber whether he is a buyer or a seller, asks him to quote a price, and, once having quoted a price, the jobber is, by the rules of the House, bound to do business at the price up to an amount which in the case of stock or bonds is fixed at £1,000, and in the case of shares, from 10 to 100 shares, according to their value. Say the jobber quotes 99 to 100 as the price; the broker, if he is satisfied, mentions the amount he wishes to buy or sell, and the bargain is duly entered; but he may think the margin between the two prices is too large, in which case he will ask for a "closer" price. If the jobber consents to this he may quote 99¼ to 99¾, or perhaps 99½ to 100. The extent of the margin between the two prices quoted depends upon the volume of the transaction in the particular security. If it is one which is being constantly bought and sold, the difference will be small, as, for instance, in the principal British Government securities, where the difference is rarely more than one-quarter. If, on the other hand, it is a security in which few transactions occur, and which therefore the jobber may find difficult to deliver or to sell again, the difference will be much greater, and quotations of securities such as local brewery stocks may be found at, say, 88 to 91.

The securities which are dealt in on the Stock Exchange may be divided into three main classes—stocks, shares, and bonds.

The capital of a company or the amount of a government or corporation loan is sometimes issued so as to be divisible more or less at the will of the

purchaser, in which case it is called "stock." Some stock, such as that of the Consolidated Fund, can be dealt with in any sum, so long as fractions of a penny do not occur, whilst other stocks can only be bought or sold in multiples of a pound or five pounds, and so on. English stocks are always quoted on the Stock Exchange for the £100 of stock.

In other cases the capital of a company is divided into a number of fixed and usually equal portions which cannot be divided, in which case these portions are called "shares."

A debenture bond is a promise to pay a certain sum of money with interest, usually in English companies £100 or multiples of £100, but occasionally for smaller sums. They may be redeemable, either at a fixed period or at a time which shall be determined by the public drawing of lots; in other cases they are irredeemable. Many debenture bonds are secured by a "floating" or specific charge over the general effects of the company, but this is not a necessary qualification of a debenture.

British Government Stock is usually "inscribed" in the books of the Bank of England. The owner's title is evidenced by the entry in the books, and no document of title is issued, the stock receipt given at the time of purchase being of no use as evidence of title. All transfers of stock have to be made by the personal attendance at the Bank of England of the proprietor or of a legally appointed "attorney." In the case, however, of most railway and other companies, a stock certificate is issued, which is *prima facie* evidence of title and which must be produced whenever the stock is transferred to

another holder. Similar certificates are issued to the proprietors of shares. In the case of a transfer of the stock or share from one proprietor to another, the company requires the production of a duly executed transfer deed before registering the title and issuing the new certificate.

Most American Railroad certificates have a blank form of transfer on the back, and in order to expedite their negotiability in this country it is the custom for the registered holder to sign the transfer in blank and for the certificates to be dealt in as if they were bearer securities negotiable by delivery. The registered holders are usually certain well-known firms in London, but the real owner is the possessor of the certificate. Dividends are paid to the registered holders, and are handed on to the real owner on production of the certificate, a small commission being usually charged for so doing.

A bond is usually payable to bearer, and if so, is transferable by mere delivery, with the least possible delay and formality. Most of the international securities, such as foreign government loans, are issued in the form of bearer bonds, in order to facilitate their transfer from one country to another. Attached to the bearer bond is a sheet of paper slips called "coupons," each of which entitles the holder to interest for a certain period, either three months, six months, or a year. The coupons are distinguished by numbers, corresponding to the number on the bond, as well as a number indicating the order of payment. The company has no knowledge of the ownership of the bonds, and pays

the coupons to the individual presenting them. No bonds will be dealt in on the Stock Exchange unless all the coupons are attached, and when these are exhausted and the bond is not yet due for payment, it is necessary to send the latter to the officers of the company or the agent of the government, as the case may be, in order to obtain a fresh sheet, unless there be attached to the bond a slip called a "talon," the production of which entitles the individual presenting it to a fresh supply of coupons.

The holders of mortgage debenture bonds have a priority both as regards capital and interest, not only over the shareholders, but also over the unsecured creditors.

Very often debentures are issued in several series, first debentures, second debentures, and so on. In this case the claim of the holders of the second debentures to payment of capital and interest is postponed till the holders of the first debentures are satisfied.

Next in priority to the debenture holders as regards the payment of interest come the preference shareholders; in the case of cumulative preference shares they obtain a right to the payment of any arrears of interest which may exist before the holders of ordinary shares obtain a dividend. Lastly, behind the ordinary shareholders come the holders of deferred shares, whose claim to interest or dividend is postponed to that of all the preceding. In the case of debentures and preference shares, as well as in ordinary shares if deferred shares have been created, the rate of interest is fixed, either absolutely or proportionally, and the deferred

shareholders, or if there are none, then the ordinary shareholders, divide the residue of the profits which have been appropriated for dividend purposes.

The holders of shares or stock are not entitled to the return of their capital except in the case of the liquidation of the company; they have only a right to the interest or dividend on a nominal amount; but debenture bonds are in nearly all cases redeemable, either at a time mentioned in the bond, or by drawings spread over a number of years. The numbers of bonds which have been drawn for payment are advertised in the leading papers, for in the case of bearer bonds the owners cannot of course be notified. If the bonds are kept with a banker, he will usually inform his customer in case one is drawn for payment, but there is no legal obligation on a banker to do this, and he is not responsible for any loss incurred by his omission to do it. In the great majority of cases, if the bond is not presented, the next coupon is returned unpaid with the answer "bond drawn."

The principal stocks of the British Government, instead of being inscribed in the books of the Bank of England, can, at the option of the proprietor, be held in the form of registered stocks or bearer certificates or bonds with coupons attached. Bearer securities avoid the formalities of transfer which, in the case of continental holders especially, was a serious bar to dealings in the stock, though the increased convenience is to some extent counterbalanced by the risk attaching to securities negotiable by delivery only.

Consols, War Loan, and other British Government Stocks may also, at the option of the holder, be registered at the Bank of England, transferable by deed.

"Scrip" or "scrip certificates" are provisional certificates issued by a company or other body to bridge over the interval before the definitive bond or certificate is ready. A new issue of capital or a newly-floated Government loan is usually payable in instalments spread over a period of some months, and until all these instalments are paid, full certificates will not be issued; but in order that the security may be dealt in on the Stock Exchange, scrip is issued, usually payable to bearer, with receipt forms attached for the various instalments. When these are all paid, upon production of the scrip with the receipts duly signed, definitive certificates are issued in exchange. Bearer bonds and bearer scrip are by mercantile custom negotiable instruments, that is to say, the individual who obtains possession of them for a valid consideration and without knowledge of any defect in the transferor's title, acquires a good title, notwithstanding any defects in a previous holder's title. This is an exception to the general operation of English law. If a man purchases any article which is not a negotiable instrument and the person from whom he bought it has no title to it, as, for instance, when the article has been stolen, he is liable to the true owner for its value, except only when the sale was in "market overt." But negotiable instruments are transferable by endorsement and delivery or by mere delivery, and the *bona fide* transferee for value gets a good

title in spite of any previous theft or other bar to a good title.

We can now return and follow the operations on the Stock Exchange mentioned at the beginning of the chapter. After the broker has made his bargain with the jobber, a contract is prepared and despatched the same day to the broker's customer. This contract note states the nominal amount of stock or the number of shares bought or sold, the price to be paid, and the commission charged by the broker, varying from one-eighth per cent. upwards according to the nature of the security; it also states when the bargain has to be settled. Securities are bought and sold on the Stock Exchange either for cash or for "the account." If for cash, the bargain must be paid for and the securities delivered at once. British Government securities and Dominion, Colonial and Provincial Government securities may be dealt in for cash only, but dealings in other securities may be either for cash or for the account.

Settling days for bargains entered into "for the account" are held approximately once a fortnight.

The settlement occupies four days: the first, the "Contango day"; the second, the "Ticket day"; the third, the "Intermediate day"; and the fourth, the "Account day."

On Contango day it has to be decided whether the bargain is to be completed; if this is not convenient, the settlement of the bargain is postponed till the next account by the following process: We

will suppose that a broker has bought £500 Southern Railway Preferred Stock at 92, and when the next settling day comes his client is unwilling to pay for it, since he believes the price will shortly rise, and that he can sell and profit to the extent of the difference. The broker goes to the jobber he has bought from, or to any jobber if necessary, and sells it back at the current price at 11 o'clock on the carrying-over or Contango day, called the "making-up" price, at the same time contracting to buy it again at the same price for the next ensuing account. Say the making-up price is 90. The broker's client will pay the difference of £10 on the £500 stock at once, and the payment of the remaining £450 will be postponed till the next account. Besides this the buyer will have to pay interest for the fortnight's postponement of payment at a rate called the "contango rate." It sometimes happens that there have been a great many sales of a particular security and that it is difficult to obtain stock to deliver to the buyers. In this case very often it is the sellers who are anxious to carry over the bargains, and instead of the buyer having to pay interest for the postponement of payment, the seller may offer to pay the buyer a premium for the privilege of carrying over. In this case the rate is called a "backwardation" or "back." It must not be imagined, however, that if a seller is unwilling to deliver that he will necessarily have to pay backwardation. Whether he is paid a contango or has to pay backwardation depends, not upon the individual bargain, but upon the general relations of demand to supply in the particular

security. Briefly stated, if there is a "bull" account in the security contango rates will prevail; if a "bear" account, backwardation will be more in evidence.

These terms demand a few words of explanation.

The words in use on the Stock Exchange are strangely suggestive of a menagerie, and to tell the truth, if rumour speaks true, the House behaves at times more like a menagerie than a society of highly respectable business men. Anyhow, we hear of "bulls," "bears," "stags," "guinea pigs," "kangaroos," "wild cats," and "lame ducks," among other members of the animal kingdom.

A "bull" is a man who has bought securities which he does not intend to "take up" and pay for, but hopes to sell at a higher price and profit by the difference; in short, a bull "buys for the rise."

A "bear," on the other hand, is one who has sold securities which he does not intend to deliver, but hopes to buy back at a lower price. He has "sold for the fall."

All Stock Exchange business can be divided into two main classes. There is the class of business entered into by the investing public, who buy securities which they pay for at the next account and hold as an investment, or who sell stock only which they possess, because they require the money for some purpose.

The other class of business is that carried on by the more adventurous members of the public who deal in stocks which they never intend taking up or delivering as the case may be, but whose object is

to make a profit from the differences between the prices at which they buy and those at which they sell. These are the speculative classes, to which belong the bulls and bears. If in the course of an account, that is, between one settling day and another, bull operations have predominated in any group of securities, it is said to be a bull account, and contango rates will prevail. Similarly, if it is a bear account, there will be many brokers who have sold but are unwilling or unable to deliver, and backwardation rates will prevail.

Many of the rather sensational reports which occasionally enliven the Stock Exchange are the direct result of bull or bear accounts, and are circulated by speculators with the object of inducing the public to buy or sell, as the case may be, in order to make the price of certain securities rise or fall.

It may be remarked that since it is considered inadvisable that bank shares should be subject to speculative influences, and in order that, owing to the heavy liabilities of the banks to the public, the shares should, as far as possible, be held by the investing classes, an Act called "Leeman's Act" was passed in 1867, according to the terms of which all contracts for the purchase or sale of the shares of joint stock banks, must mention the registered numbers of the shares. This was intended to prevent operators selling shares which they did not possess; but the Act is often disregarded and is practically a dead letter.

Bull operations do not necessarily have the effect of sending up prices, even for a sufficient period for

the operators to realise; neither do bear operations always have the reverse effect. If bulls have bought and the anticipated rise does not come, they may be compelled to sell at a loss, and this forced selling will probably send prices down rapidly. The market very often knows that there is a heavy bull or bear account in a particular security, and, anticipating a reaction, they hold off and await events before buying or selling as the case may be.

After the carrying-over day comes the "ticket-day" or "name day," which is devoted to finding out who is going ultimately to take up or deliver securities which have been dealt in during the account. It takes its name from the tickets which are passed through the Settling Department or Clearing House of the Stock Exchange. The last day is the "pay day," all differences being paid by crossed cheques on a Clearing banker.

A few words are necessary as to the quotations of prices. When a bargain is struck between a broker and a jobber, either may have the bargain "marked," in which case the price at which it was effected is posted publicly on a board. Prices are also telegraphed to the evening papers by the Exchange Telegraph Company, who are allowed to be in the House for this purpose; they are called "tape prices," the word being taken from the long strips of paper on which the reproducing machines of the Exchange Telegraph Company record their telegrams. The Stock Exchange publishes a daily official list of the more important securities dealt in. The right to be quoted in this list is only granted to companies which comply with certain

regulations as to the allotment and registration of capital.

The official list, which is the basis of that appearing in the morning papers, contains two principal columns, those of the "business done" and of the "closing prices."

The first consists of the prices of actual bargains which have been marked during the day, and is a better indication of the real level of prices than the second. The closing prices are often little more than nominal; it may be that no dealings have taken place in a particular security for several days, and in this case the closing price would be either that of the last bargain made or an approximate calculation of what the price is likely to be.

It will be noticed that some prices are marked with the letters "x.d."—*i.e.*, *ex* dividend. It is a general rule on the Stock Exchange that securities are sold *cum div.*—*i.e.*, with the accruing or declared dividend—up to the time the shares or the stock are quoted *ex div.* Most companies close their books for a short period while the dividend warrants are being prepared, and will not register a transfer. The warrants are posted to the holder registered at the time of closing the books, but if he has in the meantime sold his shares or stock before the price is quoted *ex div.* he must surrender the dividend to the buyer. As a rule prices are quoted *ex div.* on the account day following the declaration of the dividend, but securities in the mining, oil and rubber markets are only quoted *ex div.* on the account day following the payment of the dividend; the price

in either case, allowing for market changes, falls to the extent of the dividend just paid. The terms "*ex* interest" and "*ex* rights" have a similar application, the latter usually referring to the right to subscribe to a new issue of capital, preference in such cases being often given to the holders of the original capital, to the exclusion of the public.

CHAPTER XXIV.

FINANCIAL CRISES.

THE peculiar regularity with which financial crises occurred during the nineteenth century, at intervals of as near as possible ten years, has given rise to extraordinary theories to account for these so-called credit cycles, no less an authority than Professor Jevons seeking to find an explanation in the periodic recurrence of spots on the sun's surface.

Such theorists seem to wander unnecessarily far afield in their search for a cause, but, although we cannot perhaps accept such explanations, yet we cannot but be impressed by the striking regularity of these crises.

In 1825 there was an especially virulent panic, usually attributed to speculation in foreign mining companies, when the Bank of England was reduced to issuing forgotten £1 notes. In 1836 there was a crisis which was one of the immediate causes of the restriction of country note issues by the Act of 1844. Again in 1847 speculation in railway companies precipitated a crisis which necessitated the suspension

of a part of the Act of 1844. Ten years later a totally unexpected crisis took the mercantile world by surprise, and resulted in a second suspension of the Act.

The next, and probably the worst panic, that of 1866, is usually associated with speculative company promotion following upon the passing of the Companies Act of 1862, and was precipitated by fluctuations in the price of cotton due to the American Civil War. It was especially notable for the failure of Overend, Gurney & Co., the bill brokers, with liabilities of over ten millions. For the third time the Act of 1844 had to be suspended, and such was the gravity of the situation that the Bank Rate remained for three months at 10 per cent. England's credit has seldom been so low on the continent, and notwithstanding the high rate of interest, gold was attracted very slowly.

The last of the series occurred in 1875, and is generally ascribed to the reaction following the abnormally high prices of 1872 and 1873, and to the great amount of accommodation bills in existence.

The City of Glasgow Bank failure in 1878 caused some anxiety in London, but did not produce an actual crisis, and the suspension of Baring's, in 1890, might have easily caused a panic, but for the promptitude with which the Bank of England and the leading joint stock banks joined in guaranteeing the engagements of the defaulting firm.

A study of these crises seems to convince us that in economics, no less than in the physical world, the

law is true that "Every action has its reaction, equal in extent and opposite in direction." After each crisis comes almost invariably a period of stagnation. Speculation is checked, moneyed men are afraid to venture, prices droop. This state of affairs gradually and naturally wears away. Men become more enterprising, confidence returns, speculation grows and gives way to over-speculation, and over-speculation ends suddenly in a monetary crisis, and maybe a panic.

Speaking generally, all, or almost all, monetary crises are caused by excessive speculation. John Stuart Mill has an excellent description of the steps which lead to such crises (*a*): "There is said to be a commercial crisis when a great number of merchants and traders at once either have, or apprehend that they shall have, a difficulty in meeting their engagements. The most usual cause of this general embarrassment is the recoil of prices after they have been raised by a spirit of speculation, intense in degree, and extending to many commodities. . . . At periods of this kind a great extension of credit takes place. Not only do all whom the contagion reaches employ their credit much more freely than usual, but they really have more credit, because they seem to be making unusual gains, and because a generally reckless and adventurous spirit prevails. . . . When, after such a rise, the reaction comes and prices begin to fall, speculative purchases cease. When everybody seems to be losing, and many fail entirely, it is with difficulty that firms of known solidity can obtain even the credit to

(*a*) Political Economy, Book III., Chap. XII., s. 3.

which they are accustomed, and which it is the greatest inconvenience to them to be without. . . . There is superadded in extreme cases a panic as unreasoning as the previous over-confidence; money is borrowed for short periods at almost any rate of interest, and sales of goods for immediate payment are made at almost any sacrifice."

If we analyse the above paragraph, we find three important points to remember: First of all, there must be a speculative spirit abroad, "a generally reckless and adventurous feeling," as Mill calls it. Unless this feeling becomes general, it is almost impossible for the demand for credit to assume such proportions as to threaten the stability of the financial world. Take, for example, that form of business which is mostly openly speculative, that is to say, Stock Exchange operations; at intervals recurring with what almost amounts to regularity we meet with periods, may be for years in succession, during which the public refuses to be interested in the doings of the speculative markets or to give their assistance in forcing up prices. In spite of some clever engineering, prices have gradually drooped, and the embryo "booms" have died at their birth, the chief reason being that the spirit of speculation was, for the time being, dormant.

Secondly, it will be noticed that speculation acts by means of its effect upon prices. Speculation means an increased demand, it may be for the majority of commodities, it may be for one particular commodity, but in the latter case such a rise will usually affect the prices of all commodities in that

group, because what is a finished product in one trade is only raw material in another.

The third point to remember is that speculation acts upon prices by means of an increase in credit; "at periods such as these," says Mill, "a great extension of credit takes place."

If credit did not exist and everything had to be paid for in gold or silver, the limitations of speculation would be very narrow. The quantity of gold in circulation and in reserve cannot be greatly increased at a moment's notice, and taking for granted that nothing occurs to diminish the supply of goods offered for sale, you cannot have a general rise in the prices of commodities, except by increasing the quantity of money in circulation or its rapidity of circulation, and the only way of so increasing the quantity is by the creation of credit.

Up to a certain extent this can be safely done in a country like England. Our currency is "elastic," and there is no absolutely fixed relation between the amount of credit and the gold basis upon which it rests. But beyond certain limits there is a great danger attaching to the creation of credit, and the greater the inflation of credit, the more violent is the inevitable recoil in prices which leads up to the monetary crisis.

It must not be imagined that speculation has necessarily an evil effect upon business conditions. It is somewhat difficult to define speculation, because there is a speculative element in all modern business transactions, but the term is used here to denote particularly that class of business enterprise which is prompted by the expectation of a rise or fall in

prices, and which is very often carried on with borrowed capital. Up to a certain point speculation of this kind is productive of more good than evil, and undoubtedly helps to prevent wide fluctuations in price. If the price of any commodity falls abnormally, the speculator steps in to buy, and so raises the price. Conversely, a rise in prices tempts the speculator to sell for the fall. In all markets, whether stocks and shares or corn or cotton, the speculative operator is always at work, and by his dealings hinders prices from fluctuating too far in either direction.

But speculation occasionally runs wild, and it is then that it begins to be harmful. Speculation is good, over-speculation is excessively dangerous, because the artificial raising or lowering of prices is sure to result in a recoil, resulting in a contraction of credit and widespread disaster.

America is the home of the speculator, one of the reasons being that immense sums of money are controlled by individuals or syndicates. The artificial interference with prices in a particular market can therefore be carried to a great extent, and sustained for a long period. In England we have as yet had few instances of such concentration of capital as is characteristic of American finance, and the speculator has often to depend upon borrowed capital.

We can now estimate the position of bankers in this country in those periods of reckless speculation which have culminated in a monetary crisis. It is safe to say that bankers cannot originate speculation. Without the existence of a spirit of speculation and the anticipation of making a quick profit, there

will be but a small demand for borrowed capital from the productive and commercial classes. It is these classes who originate speculative movements. But, as we saw above, no speculation can spread very far without an extension of credit, and to some extent bankers can control the amount of credit at the disposal of the commercial classes. To a limited extent only this is true. A banker cannot know, and it is not a banker's function to inquire, the purposes for which each individual customer requires an advance, and whether his business is of a speculative character. If the banker decides that the loan is a safe one, and he can spare the money, he will usually be content with this knowledge.

But when the signs of speculation are evident to a banker, and to an experienced practical man of business it is not difficult to detect such signs, he can discourage further borrowings by raising the rate of interest, or refusing to lend, and he can prepare against possible emergencies by strengthening his own position and increasing his "liquid" assets.

When the early signs of an approaching crisis are detected, the first step should be to raise the prevailing rate of interest. This operates in two ways: (1) it attracts foreign capital and so helps to attract gold by turning the exchanges in our favour; (2) it discourages borrowing.

Neither of these effects is certain. In normal times a rise in the rate of interest is certain to attract gold eventually, but in times of panic the foreigner may balance the increased risk against the increased profit, and decide against us. In the

second case, as Mill points out in the paragraph quoted above, when panic has seized the commercial classes and failures follow each other in rapid succession, no increase in rates will discourage borrowing on the part of those whose position is desperate. It becomes a matter of extreme urgency; money must be obtained whatever the cost, and if the rate were raised to 50 per cent. there would be plenty of people who would borrow to escape certain failure.

But a word of warning is necessary. A very sudden rise in the rate of interest is often the most dangerous proceeding in cases of panic, because it has the effect of aggravating the prevailing feeling of nervousness and distrust, and is regarded by the public as a sign of weakness. When a crisis is imminent, the first step on the part of those upon whom responsibility rests should be to restore confidence; once this is done, the rest is easy. If one may make use of an everyday simile, the rate of interest at the time of a monetary crisis may be likened to the brake on a bicycle which is descending a steep hill with sudden and unexpected gradients. A rash use of the brake at the worst part of the hill will probably only precipitate the calamity which it is desired to avoid. The brake must be gradually brought into play in the earlier stages of the descent, and in like manner the rate of interest should be raised before the crisis has had time to develop into a panic.

The second palliative to a panic is the free lending of money in all quarters where lending is warranted and the security is satisfactory. A refusal to lend might be the natural desire of banks, in order to

strengthen their own position, but this restriction of credit should have preceded the time of the panic; once the public is alarmed money must be lent in order to restore confidence. It must not be forgotten that every failure at such times is apt to bring about a series of catastrophes, because the suspension of payment by a business firm ties the hands of all of its creditors, as well as spreading alarm in other directions.

If neither of these steps results in the restoration of confidence, the last resource has been the suspension of the Act of 1844. A long-continued crisis must inevitably diminish the Bank Reserve, and as this Reserve gradually approaches the point of disappearance, the nervousness of the public is apt to become acute. Three times the suspension of the Act has been necessary—not counting that of August, 1914—and every time it has had the desired effect of restoring confidence. The feeling that a further reserve of Bank notes has been created seems to bring about a revulsion of opinion and dissipate alarm.

Perhaps it is necessary to explain clearly what is meant by the "suspension of the Bank Act." A question set in a recent examination in banking came under the notice of the present writer, in which the examiner referred to the suspension of the Act as a "restriction of cash payment" by the Bank of England. Needless to say, this was quite wrong. The suspension was not even a complete suspension of the Act, but only that part of Section 2 of the 1844 Act which forbids the issue of notes beyond the amount of the securities lodged in the Issue Department, except in exchange for gold or silver. No

restriction of payment in cash was sanctioned or contemplated in any of the three suspensions referred to, and all notes presented during the period of suspension were paid in gold if desired. The letter signed by Earl Russell and Mr. Gladstone, in 1866, authorising the suspension, runs as follows: ". . . If, then, the directors of the Bank of England, proceeding upon the prudent rules of action by which their administration is usually governed, shall find that, in order to meet the wants of legitimate commerce, it be requisite to extend their discounts and advances upon approved securities, so as to require issue of notes beyond the limits fixed by law, her Majesty's Government recommend that this necessity should be met immediately upon its occurrence, and in that event they will not fail to make application to Parliament for its sanction. No such discount or advance, however, should be granted at a rate of interest less than 10 per cent. . . ." (*a*)

The Currency and Bank Notes Act, 1928, removed the necessity for this rather clumsy step of suspending the Act, by giving the Treasury power, on application by the Bank, to increase temporarily the amount of its fiduciary issue.

The most recent examples of a financial crisis are that which this country endured in the years 1920–21, and that of 1931, the latter of which will be dealt with in another chapter. The close resemblance of the former to the crises of the nineteenth century will, upon examination, be found to be most marked, though masked by the fact that it did not culminate in a financial panic, largely owing to the greater strength

(*a*) "Gilbart on Banking," Vol. II., p. 317.

of our banking system and the wider experience gained by our bankers, and by the further fact that gold was no longer available for the settlement of international balances and that, in the absence of a free gold market, men doubted the effect of the time-honoured remedy of raising discount rates. At the end of the War the British nation, flushed with victory and relieved of the terrible nightmare of the desperate struggle for national existence, resolutely faced the fight to regain its commercial and industrial pre-eminence. The whole world was starved for the products of British workshops, and work had to be found for the four or five million men about to be demobilised from military and naval service. In public and in private it was dinned into the ears of the bankers that whatever happened adequate financial facilities must be provided for the expansion of British trade and manufactures. Consequently there were present to an unusual extent all the elements needed for a period of intense speculative effort. The banks lent freely and the speculative spirit was rampant. Prices soon began to soar under the influence of the rush for raw materials, but during the War producers had learned that the cost of increased production could, in the circumstances that then reigned, be transferred with impunity to the consumer. Demand was apparently insatiable and profits seemed assured. The only difficulty was in obtaining adequate supplies of raw materials. Hence manufacturers, retailers, and merchants did not hesitate to enter into forward contracts at prices which in calmer moments would have effectively stopped the demand. The *Economist* Index number,

(100 = average for the years 1901–1905), which at the cessation of hostilities in November, 1918, was 282·6, had by March, 1920, risen to 379·8. The Index number of raw materials and manufactured articles shows an even greater proportionate increase.

Textiles, for instance (500 = average for 1901–1905), rose from 1848 in November, 1918, to 2974½ in March, 1920. But the rise in wholesale prices was not accompanied by a corresponding rise in retail prices. There was not sufficient purchasing power in the country to support such prices. Without a wholesale inflation of the currency it was hopeless to expect goods produced at such cost to find a market at remunerative prices. The Government declined to inflate. The banks, rather late in the day, realised the unhealthy nature of the financial situation and began gradually to tighten their grip. Requests for further advances were met by demands that stocks should be liquidated. At the same time merchants and retailers began to see that they could not dispose of goods at the ruling prices. Complaints of a "consumers' strike" were heard. Contracts for future deliveries were hastily countermanded or, especially in foreign markets, repudiated. Prices began to drop and it was immediately seen that the boom was over. Extravagant optimism yielded to settled despondency, and by December, 1920, the *Economist* Index number had dropped from 379·6 to 269·3.

What distinguished the crisis from its predecessors was, first, that instead of a gold standard and a gold currency, we had a paper standard and a paper currency, expansible at the will of the Government,

and safeguarded only by the declaration of the Government that they intended to follow the recommendation of the Committee on Currency and Foreign Exchanges and to make the minimum amount of the Currency Note Issue in any year the maximum amount for the following year. Under a gold currency an outflow of gold would have accompanied the credit inflation. Under a paper regime, the excessive currency could not escape, and its decreased purchasing power was shown in a fall in its value expressed in terms of the gold-using countries, in other words, in a fall in dollar exchange. This phenomenon, unfamiliar to English commercial men, was not recognised as a result of post-war inflation but was accepted as a result of war finance and a natural reaction against "pegged" exchanges. The second distinction was that the bursting of the bubble was not followed by any bank failures and by very few mercantile failures. The greater stability and the greater experience of the banks enabled them to nurse their creditors and to prevent the general loss of confidence from degenerating into panic.

CHAPTER XXV.

THE OUTBREAK OF WAR.

IN order to understand the difficulties which beset the London Money Market at the outbreak of war in August, 1914, a short explanation of the methods by which bills of exchange are handled in London is necessary.

Let us see what happens when goods are imported into this country. A typical example will suffice. We will say an English firm is importing coffee from Brazil or nitrate from Chile. The exporter will probably wish to be paid by a bill on London. The reasons have already been explained in Chapter XXI. A bill on London with first-class names on it is the international currency. It will be bought in any country in the world, because every country has dealings with London, and every foreign bank has a London office or a London correspondent. A bill on any other centre might find a purchaser, but not with the same certainty as a bill on London. The English importer, therefore, arranges with his banker to open a credit in favour of the South American exporter; in other words, the South

American is given the right to draw a bill on an English bank or accepting house, and the bank or accepting house undertakes to accept the bill if accompanied by the usual documents, bill of lading, invoice and insurance policies, showing that the goods have been duly shipped. The foreign exporter, armed with the letter of credit, is enabled to discount the bill at once with his own banker in South America and thus gets his money immediately the goods are shipped. The bill, when it is sent to London by the bank which has bought it, is accepted if the documents are in order, and the documents are probably released at once so that the English importer may get the goods without delay from the docks. When he has got the goods he sells them, and with the proceeds he provides the funds for meeting the bill when it becomes due, usually sixty or ninety days after sight or date.

We must remember that the bill, which has been accepted, is the property of the South American bank which bought it, and is held on his account by his London agent. What happens to this bill in the interval before it falls due? We do not know with certainty. It may be remitted to another financial centre to settle some account, but the majority of such bills will find their way into the portfolio of a London bill broker or London bank. Here we will leave them for a while and consider another similar case.

Let us now take the case of a German importer who wished to buy coffee from Brazil or nitrate from Chile. Coffee is consumed in very large quantities by Germans, and nitrate is a necessity to the German

farmer for manuring his crops of sugar beet. There was, therefore, at any given moment a heavy account open for the payment of these commodities, among many others, imported into Germany.

When the import was arranged, the South American exporter would probably not be content with a credit on Berlin. A Berlin bill did not find such a ready market as a bill on London. Therefore, as a matter of fact, a very large proportion of these German imports were paid for by London accepting houses and banks. The German merchant got his documents, and by these means obtained possession of the goods, but, it will be observed, he did not, in most instances, pay for these goods until the bill was about to fall due. The seriousness of such a position, when war broke out and financial relations between Germany and England were cut off, will easily be seen.

The position of the accepting houses demands a few words of explanation. There are many firms in London a main portion of whose business consists in lending the credit of their name by accepting bills against shipments of goods. The names of these firms are household words in the City.

They accept bills drawn upon them under credits, charging a small commission for doing so, usually a quarter of 1 per cent. for three months. Such bills, when accepted, become first-class bills, that is bills which will be discounted by the Bank of England if need be, and will find a ready market in any banking centre in the world. At one time practically the whole of this accepting business was in the hands of these firms, chiefly at the time foreigners, but now a large and increasing part of this business is done by the banks,

both the Clearing Banks and the Foreign and Colonial banks. The volume of such business is reflected in the balance sheets of the banks by the item on the liability side. "Acceptances on behalf of customers as *per contra*," the corresponding item on the asset side being the liability of the customers to provide for the acceptances at maturity.

We are now in a position to understand the effect of the declaration of war on one section of the Money Market, viz.:—the accepting houses, the discount houses, and to a smaller extent the London banks. It must be remembered that the acceptors of these bills cannot at maturity refuse to meet them on the ground that they have not been provided for. The accepting house, by putting its name on the bills, undertakes unconditionally to meet them at maturity. Most of the bills are in the hands of English holders for value, so that payment cannot be refused on the ground that it would be payment to an alien enemy. The author is not prepared to give any estimate of the total amount of these acceptances on German and Austrian account, but a writer in the *Round Table*, writing in 1912, stated that the normal amount of such bills, on German account only, was probably about 70 millions sterling.

With such enormous amounts gradually falling due it can be seen that the position of the accepting houses was uncomfortable in the extreme. As regards the large joint stock banks, though the locking up of so large amounts would be likely to impair their power of making advances to others, yet their resources are so large and the business of accepting is comparatively such a small part of their total business,

that their stability would not be endangered. But with a firm whose capital is fully employed in financing trade the position is very difficult, and however solid and wealthy these houses might be, it was generally recognised that they could not be expected to bear the whole burden of the shock without some measure of relief. The London Money Market deals in *short* credit, and money rapidly changes hands. The funds lent are all regarded as money easily realisable. Consequently the inability of one party to keep his engagements is rapidly felt throughout the market. If the acceptor cannot meet his bills, the bill broker who holds the bill cannot discount further bills, and cannot pay off the loans which are due to the banks. Any defalcations on a large scale would in fact rapidly lead to complete paralysis.

But these acceptances on foreign account were only part of the burden which the outbreak of war threw upon the Money Market. There was a large volume of bills held in London accepted by German and Austrian firms and payable abroad. There was, of course, no hope that these would be met at maturity. Then there were the acceptances of the London offices of the German and Austrian banks in London, and the "domiciled bills," that is, bills accepted payable in London by persons resident abroad. In addition to these it was recognised at once on the outbreak of war that many acceptors resident in neutral countries would for a time be unable to meet their bills because of the funds which they had tied up in the belligerent countries.

Enough has been said to show how the outbreak of war affected the Money Market in this one respect.

It left a mass of bills in the hands of the Market which it was hopeless to expect the acceptors to meet at once. To allow these bills to be dishonoured was unthinkable. If the acceptors could not meet them it was obvious that the endorsers would be for the same reasons unable to do so. The great thing to do was to give time during which each man would have the opportunity of putting his house in order, and the only satisfactory method of granting time was to shift the burden temporarily on to the shoulders of those who were most capable of bearing it. How the problem was met will be explained when we have examined the effect of the war on the other branch of the Money Market—the Stock Exchange. Perhaps it is not strictly correct to include the Stock Exchange as part of the Money Market, but it plays such an important part as a borrower in the market that the classification is a convenient one.

The loans to the Stock Exchange by the London banks amounted in the aggregate to considerably less than the loans to bill brokers. The writer in the *Round Table* previously quoted mentions that normally the London banks hold themselves about £200,000,000 of bills, and have lent to the bill brokers another £100,000,000 on the security of bills. Presumably the latter figure includes the amount lent on "floaters," that is, parcels of gilt-edged Stock Exchange securities.

As regards the loans to the Stock Exchange the Committee of the Stock Exchange obtained from its members a confidential return of the amount of the outstanding loans at the outbreak of the war. The totals of these loans was reported by the financial

Press "on trustworthy authority" to amount to £80,000,000, of which £20,000,000 was owing to lenders other than banks.

These loans are used for holding stocks and shares which the public have not yet absorbed, and which are retained in the expectation of a rise. Notices appear from time to time in the newspapers that 40 or 50 or 75 per cent. of such and such a new issue has been allotted to the underwriters, that is, to those people who for a small commission have undertaken to subscribe for so much of the stock as shall not be applied for by the public. Among these underwriters the Stock Exchange always figure largely. They get their underwriting commission and hold the stock, to a great extent on borrowed money, until the price rises and they are enabled to sell it at a profit or loss as the case may be. The money so lent to the Stock Exchange is usually lent for the account, that is to say, until the next fortnightly period fixed for liquidating bargains.

The London Stock Exchange closed on July 31st, and the reason is perhaps not apparent. Immediately it became obvious that war was probable, that is, from the issue of Austria's ultimatum to Servia, there was a rush to sell securities throughout the Stock Exchanges of the world. Every one wanted to get some ready money to meet emergencies, and speculators who were holding stocks for the rise had to close their book and sell, if possible, even at a heavy loss. There was therefore an immediate and rapid fall in prices. The Continental bourses, if not formally closed, ceased all transactions a day or two before London and New York, and this threw an enormous strain on these two

Exchanges. The London Stock Exchange was flooded with orders to sell from every part of the world, and on July 31st the House closed. Any other course was out of the question. It was not a question merely of the members meeting their liabilities, it was apparent that to keep open any longer would mean that London would be the dumping ground of the world, and that London's gold would be exhausted by the avalanche of securities sent out to be realised at any cost.

It is impossible, while the Stock Exchange is open, to discriminate between domestic and foreign orders. The great mass of international securities, that is, securities which in normal times find a ready market in all the bourses of the world, are either bearer securities or securities such as American rails which, by being endorsed in blank are for all ordinary purposes bearer securities. Even had it been possible to draw any such distinction, the machinery of the Stock Market is so delicate that to keep open any longer would threaten disaster. About eighty millions had been lent to the Stock Exchange and practically all this money was lent "on margin." That is to say, the banks require security to be deposited, and to be maintained of a market value which is from 10 to 20 per cent. above the value of the loan. If the market value of the security declines, more security is called for to keep up the margin. The enormous decline in values which occurred in the last week of July therefore meant that this margin had in most cases disappeared. If the borrower cannot find more security of the kind on which a bank advances, he will probably have to sell some of his less gilt-edged

securities to pay off part of the loan. These sales inevitably still further depress prices, not only of the stock sold but of all stocks, which fall in sympathy, and so the process goes on.

We are now in a position to see the state of the City on Friday, July 31st, by which time it was generally realised that the peace of Europe could not be maintained.

Next to its cash in hand and at the Bank of England, the most liquid resources of a bank are employed in three ways: in the discount of bills, in advances at call and short notice to the bill brokers, and in advances to the Stock Exchange. All these resources were absolutely locked up. It was fairly certain that a large proportion of the bills could not be met at maturity. It was impossible, and it would have been folly to attempt, to call in the loans. In normal times if a bank calls in its loans, the borrower takes his security to another bank and pays off the first bank with the proceeds of a new loan. Obviously, none of the banks would make further loans to the Stock Exchange, and therefore calling in money could only have the effect of forcing borrowers into bankruptcy. There was only one place where further loans could be obtained, and that was at the Bank of England. As explained in an earlier chapter, the Bank of England, even in times of crisis, does not refuse to lend to any customer on approved securities. She only protects herself by raising her rate. On July 31st Bank Rate, which had been 4 per cent., was raised to 8, and on the Saturday to 10 per cent. In addition to the loans at the Bank there was a heavy demand for gold. How far this demand was real and how far

it was the result of nervousness, is uncertain, but it was evident that the Bank of England reserve was seriously threatened.

These two days, Friday and Saturday, were the worst days in the City during the whole crisis, before and after. The actual outbreak of war, which had by then become recognised to be inevitable, was a shock which might well try the nerves even of a people as phlegmatic as we are commonly supposed to be. It must be remembered that the delicate financial mechanism of modern London had never been put to the test of a European war. The Franco-German War of 1871 occurred too long ago. International financial relations have developed wondrously since that time. The question everybody was asking himself or asking others was, how can London bear the strain? Remember that by this time it was by no means certain that England would be involved in the war. But from a financial point of view London is not merely the metropolis of Great Britain, it is the centre of the world, and it was fully recognised that even if England remained neutral, the effect of a European war would be almost as severe a strain as if she were one of the combatants.

It is now generally admitted that the action of the Bank in raising its rate to 8 per cent. on July 31st and to 10 per cent. on August 1st was a mistake, and tended to accentuate rather than to assuage the general feeling of distrust. It was probably done in accordance with the tradition that the Bank should not ask for a suspension of the clause of the Bank Act limiting the amount of the fiduciary issue until a 10 per cent. Bank Rate was reached. The mistake was soon

realised and the rate reduced to 6 per cent. on August 6th and to 5 per cent. two days later.

The anxiety, the uncertainty, were intense, but the fact that the next day was a Sunday and was followed by a Bank Holiday, suggested the first step. Time was wanted, both to allow the public to take breath, so to speak, and also to give an opportunity to concert measures to meet the emergency. Accordingly the Bank Holiday was by Royal Proclamation extended over the three days following.

The ensuing days were fully occupied with consultations between the Government and the City. A committee of the Cabinet met committees of bankers, and of other financial interests, to discuss the best means of relieving the strain.

The first thing was to provide a satisfactory currency. Were we to have the Bank Act suspended? Were we to have an inconvertible currency? Many people believed that the outbreak of war would render both these steps necessary. The usual letter was sent by the Government to the Bank of England indemnifying them against issuing Notes beyond the limits fixed by the Bank Act. For a few days only, however, was it necessary for the Bank to avail themselves of this permission, for it was decided that emergency currency should be provided by the issue of British Treasury Notes for £1 and 10*s*., which should be payable in gold on demand at the Bank of England.

This issue of emergency currency was intended to serve two purposes. First of all it was intended to preserve the gold reserve of the Bank of England; secondly, it was intended to provide additional resources for any bank which should possibly be faced with

difficulty owing to the lock up of its resources. To bring about this latter aim, any recognised bank was permitted to borrow Treasury Notes to an amount not exceeding 20 per cent. of the total of its liabilities on current and deposit accounts. Such advances were to be secured by a floating charge on the assets of the Bank and were to carry interest at Bank rate. As can be seen by the returns which have been published every Friday, the banks only availed themselves of this right to a small extent, for of the total of £34,000,000 Treasury Notes outstanding on November 25th, 1914, only £239,000 were outstanding as loans to bankers. Still, although the privilege was not much used it was a most valuable stand-by, especially to the smaller banks, who naturally felt the strain more than the large banks.

It is easy to criticise after the event, but it is now evident that the necessary machinery should have been already in existence for providing an emergency currency with the least possible delay. In Paris, five-franc notes were in circulation by Monday, August 3rd. In London it was not till four days later that Treasury Notes were in the hands of the public, and the delay caused intense inconvenience owing to the difficulty in obtaining change. On the Friday and Saturday, July 31st and August 1st, some of the branch banks made the mistake of paying their customers in Bank of England notes instead of gold, with the result that a queue of people waiting to change these notes was to be seen at the Bank of England. There was no evidence whatever of distrust of the notes, but there was a universal lack of change throughout the four days when the banks were closed. Had the notes

been available on the Tuesday, there is every reason to believe that the extra holidays would have been unnecessary, and the possibility of alarm or distrust of the banks would have been rendered more remote.

Having provided an emergency currency, the next step of the Government was to provide some protection for those who were unable to pay their debts, and this was done by the usual method of a moratorium—usual, that is to say, in other countries, though for us there is no precedent.

With regard to the moratorium it is only necessary to say here that it was never intended to be more than a temporary expedient, and the Chancellor of the Exchequer never concealed his intention of abolishing it at the earliest opportunity. A moratorium is a millstone round the neck of the commerce and finance of the country. It prevents the circulation of money when every endeavour should be made to keep money busy. Moreover, it leads to many abuses, and bankers have had before them innumerable examples of the use of the moratorium by persons whose financial position had not been affected in the least by the war.

In order to abolish the moratorium it was necessary to shift the burden of indebtedness from the shoulders of those who were unable to bear it, or from those who were prevented by the burden from performing those services which were necessary to the national well-being.

The first thing to which the attention of the Government was directed was to remove from the Money Market the dead weight of the acceptances which could not be met. This was necessary not only to relieve the accepting houses and the bill

brokers, whose position has been already described, but also owing to a fact which had not been generally foreseen, viz. :—the absolute collapse of the foreign Exchanges.

As before explained, the international currency is composed of first-class bills, principally sterling bills. But the position of the banks and accepting houses handicapped them in incurring any fresh liabilities by accepting new bills. The consequence was there were no means of making remittances, even between countries which were not at war. To ship gold was, generally speaking, impossible, because gold can only be got in large quantities in a few of the largest financial centres, and in several of these the export of gold was forbidden, in addition to which the risk of capture at sea made it too dangerous a method of payment for those countries which were at war.

Consequently at a time when every effort was being made to keep and extend our trade, merchants found their efforts frustrated by the impossibility of making remittances except at ruinous rates.

If the *ante bellum* bills could be lifted from the market, it was natural to assume that the banks and accepting houses would no longer hesitate to finance shipments of new goods and that gradually the international currency would be restored, for it must be remembered that such new transactions would not be covered by the moratorium, at least in this country.

Accordingly the announcement was made on August 12th that the Bank of England was authorised to discount under Government guarantee and without recourse to the last holder all approved bills, both the bills usually discounted by them as well as good trade

bills, and foreign bills as well as home bills, provided they had been accepted before August 4th.

This step granted immediate relief to the holders of good class bills, chiefly the discount houses and banks. All the banks did not avail themselves of the offer, and those who did only to a limited extent, but by the smaller banks and the non-banking financial houses who held bills, the announcement was received with relief. Even to the banks who did not avail themselves of the offer the benefit of the proclamation was marked, because it assisted the customers of these banks, and opened up a prospect of the unlocking of some of their loans.

It must be understood that the Government guarantee did not extend to all bills, only to approved bills. The class of approved bills was considerably wider than the class of bills usually taken by the Bank, but it had its limitations.

This announcement was followed by another which stated that on the maturity of any bill so discounted by the Bank, the Bank would lend the acceptor the money to pay the bill at a rate of two per cent. over Bank rate. While the earlier announcement gave relief to the bill brokers, the second extended this relief to the accepting houses and a certain number of traders.

Later on, and after protracted discussion between the interested parties, a Government scheme for the relief of the Stock Exchange was, early in November, announced. Like the scheme for the relief of the bill market, it aimed at patching up the situation, leaving the eventual settlement until after the war. The policy was, accordingly, dictated by the necessity of

shifting the burden of indebtedness on to the shoulders of those judged most capable of bearing it, the only policy possible in the circumstances. The banks therefore agreed to refrain from pressing for settlement of the amounts due to them, or from requiring the deposit of further margins until twelve months from the conclusion of peace or from the expiry of the Courts Emergency Powers Act. As regards debts due to lenders other than the banks, the scheme provided for loans from the Bank of England, under arrangement with the Government, to the extent of 60 per cent. of the value on July 29th of the securities held, at a rate of interest one per cent. above Bank rate.

If we may judge from the fact that the settlement of November 18th, 1914, the first since the outbreak of war, passed off, so far as we know, with far less trouble than had been generally anticipated, it may be considered that the scheme was well thought out and attained its objects.

The last body of men to obtain Government relief were the traders to whom debts were owing on open account from abroad. A Committee was appointed under the name of the Foreign Trade Debts Committee with power to make advances to such traders with the approval of the applicant's banker, through whom the application must be presented. Such advances were not to exceed 50 per cent. of the outstanding debts due from abroad, and took the form of a bill of exchange drawn by the trader, accepted by his banker, and certified by the Committee. It was left to the trader to discount such bills where the easiest rates could be obtained. Any ultimate loss

was to be borne as to 75 per cent. by the Exchequer, and as to 25 per cent. by the accepting bank.

The action of the Government during the crisis was prompt and courageous at a time when promptitude and courage were the first requisites, and the general appreciation of the action of the Government was even more universally extended to the Bank of England, which throughout displayed unbounded confidence in the soundness of the financial situation.

CHAPTER XXVI.

THE POST-WAR WORKING OF THE GOLD STANDARD.

THE end of the War found the nations of Europe with their currencies "in the air." Gold had long ceased to circulate and was either jealously guarded in the vaults of the Central banks or had found its way to America or Asia in payment of munitions or subsidies. The volume of the paper currencies was no longer limited by the necessity of maintaining a relation between its amount and that of the gold reserves held against it. The only restraint upon the money printing press was the unfettered will of the national governments, who were either in desperate need of money to meet their creditors or were bent at all costs upon reviving, in competition with one another, the industries which had been in abeyance during the war. The result was seen in a depreciation of the currency, evidenced by rising prices, and the problem was how to get the paper currencies back to ground again, to anchor them to something which would stop their indefinite multiplication and restore stability in price levels and in international exchange values.

The difficulties in the way of a return to monetary sanity were greater than appeared on the surface. Economy is never popular, more particularly when

there is a simple method of avoiding it at hand. Steadily rising prices vastly simplify the problem of earning profits, and in every country there was an influential section opposed to price stabilisation. Granted the will to do something, the question still remained what that something was to be.

Should a return be made to gold or not? Gold was admittedly an imperfect standard, and there were idealists in this country and elsewhere who wished to avoid the restraints imposed by gold and continue a paper currency the amount of which should be limited only by governmental action, guided by enlightened popular opinion. At first this was the only practicable policy, and it was followed in Great Britain with some success by a self-denying ordinance of the Treasury which restricted the highest amount of the fiduciary circulation of Treasury Notes in any one year to the actual highest of the previous year. But the example set by this country was too difficult for other nations. Germany, under political pressure to pay impossible sums in reparations, abandoned all restraints and worked the printing press to such an extent that her currency lost all value. For a time it looked as if the French franc was on the same slippery path, but recovery was made in time. Opinion all over the Continent veered round in favour of a return to gold.

There was, however, still a problem to be solved. Should the pre-war value of the paper currency in terms of gold be restored or should the currency be devalued? In England mercantile opinion was staunch in its adherence to the old gold pound, though here and there a voice was raised in favour of devalua-

tion, in order to relieve the burden on the debtor classes, chief among whom was of course the State.

In 1925 the plunge was taken in this country in circumstances which have been described in an earlier chapter. The country kept faith with its creditors and the old parity was restored. But such a step was beyond the powers of the other European countries. Depreciation had gone too far for any complete restoration to be possible and new parities with gold were everywhere created. At the same time steps were taken, under the aegis of the League of Nations, to reorganise the Central banks throughout many of the Continental countries.

The stage was now apparently cleared for a return to pre-war monetary conditions. But somehow or other the new gold standard did not work like the old. A steady fall in gold prices throughout the world followed, and during the year 1930 assumed alarming proportions. The fall was world-wide, acting as a damper on production and shewing itself in a deplorable increase in unemployment. In Great Britain the effects were particularly noticeable because of the failure of retail prices and the money rates of wages to follow the downward course of wholesale prices. Cries of a gold famine were heard, but it was plain to see that the trouble did not lie in a general scarcity of gold but in the partiality of its distribution. Three-fifths of the visible gold reserves of the world were collected in the United States and France, and in one of these countries it became necessary to sterilize a part of the unhealthy accumulation; that is to say, it became no longer a reserve against the circulating currency of the country, but a mere unemployed hoard.

What were the obstacles which prevented the smooth working of the post-war gold standard? Before the war the theory of gold movements was that an accumulation of gold in any one country resulted in an increase of prices in that country, which encouraged the flow of goods into that country and discouraged the export of goods from it, thus creating an adverse trade balance which was satisfied by gold exports. Creditor countries like England which had invested large sums abroad and to which large sums of interest had to be paid restored the balance by investing the surplus abroad.

But both of these compensating movements failed to act freely. Gold was drawn to America in payment of interest on Europe's war debts. The United States had set up a tariff barrier which was intended to prevent the payment of this interest in the shape of goods. The American investor has had but little experience in lending money abroad and some of his experiments in this direction have not been attended by success. In any event, it is doubtful whether the situation would have been permanently relieved by an extension of America's investments in Europe, so long as she maintained her rigid tariff policy and excluded Europe's goods from her internal markets. The continued flow of gold to France was also due in part to debts due to the war, in her case, reparation payments. There was also probably a trade balance in France's favour. Her population worked hard for wages which, since the war, had not been increased to the extent

to which the process had been carried by some of her competitors. Consequently, there had been remarkably little unemployment. To offset these tendencies, there was little foreign investment. Before the war, the French had invested very large sums in Russia, all of which has been lost, and it is hardly a cause for wonder that confidence in further investments abroad should have disappeared.

Added to these causes was the spirit of intense nationalism which pervaded the world after 1918. Every nation was intent upon developing its own industries to the exclusion of those of its neighbours. Each country was bent upon fostering its own export trade while declining to accept in exchange the goods produced by its own customers. Tariff walls were built higher and higher. New walls were added by the division of the old Austrian Empire into a number of independent units. International conferences were held at which pious resolutions in favour of the removal of the barriers to a free exchange of goods were passed and still the walls were built higher. Every country sought new markets while denying to other countries access to its own markets. Production was fostered by improved methods and exchange was hindered. Soon the cry of over-production arose and was met by organised attempts at maintaining prices by restriction of output, by government subsidies and financial assistance in withholding goods from market. When these failed, complaints were made of lack of con-

sumers' demand. The old cry of the inflationist that there was not enough gold to go round was revived. Mr. Henry Clay, in a recent address, put the matter in a nutshell by stating that in a more primitive condition of society any national catastrophe was commonly attributed to the action of the devil. In the more sophisticated civilisation of to-day the devil is personified under the name of the Gold Standard.

The authors of these attacks on the gold standard put the cart before the horse. The failure of the gold standard to work smoothly was not a cause but an effect of the world's economic maladjustment, and an abandonment of that standard offers no prospects of permanent amelioration. That each country should adopt its own national standard of value and let international exchange rates "go hang" is a policy of despair which inevitably puts further grit in the world's economic machinery and slow up the exchange of goods and services which is the life-blood of a healthy economic body.

There were many who hoped for much from the activities of the Bank for International Settlements which was founded in 1930 by a Committee of the Central Banks of Great Britain, France, Belgium, Italy, Germany, Japan and the United States. The immediate object of this Bank was to facilitate the transfer of the reparation payments to be made under the Young Plan. Hopes were, however, entertained in many quarters that the B.I.S., as it is sometimes called,

would form the nexus between the Central Banks of the world and so facilitate a common policy whose aim would be the stabilisation of world prices. There is a division of opinion upon the extent to which such a policy is likely or even possible of realization, but it is clear that the Central Banks can do little in this direction without the co-operation of those who are responsible for the political and economic development of the nations. There must be something of a change of heart in international relations.

CHAPTER XXVII.

THE BREAKDOWN OF THE GOLD STANDARD.

ON September 20th, 1931, the British Government released the Bank of England from its obligation to convert legal tender into gold at the option of the holder and, by so doing, severed the connection between the national currency and gold. Those who have carefully read the preceding chapters of this book will have no difficulty in appreciating the significance of the step. It meant that, so far as this country was concerned, the gold standard which had been re-adopted in 1925 had broken down.

Let us re-state the essential features of a gold standard. Since the War, gold has practically ceased to form part of the internal currency of all the more important nations, and its use has been confined to the settlement of international obligations. For simplicity's sake we will imagine two countries with mutual trading relations and ignore the rest. Country A exports certain goods to country B and, in turn, receives certain other goods from B. If the values of these imports and exports coincide, the bills drawn by the exporters on the relative importers are set off against one another in the books of their respective

banks. If, on balance, A owes money to B, A's bankers will have on their books certain balances which are the property of B's bankers or traders. This indebtedness may be temporary. If it continues B may call for repayment and, if both countries have a common standard of value, such as gold, A will export gold to B to settle their indebtedness. If it is inconvenient to do so, A may retain the money a little longer by offering a higher rate of interest on B's balances in their banks. If there is no standard of value common to the two countries, B's traders will begin to have doubts of the value of A's currency, and these doubts will show themselves in the exchange rates between the two countries. B will require more of A's currency for any goods it may continue to export to A and A will be forced to limit its imports from B, because of their increased cost, so tending towards a restoration of the balance between the two countries.

When we apply these general principles to all the countries which have based their currencies on gold, we arrive at the same result. Any country which imports more than it exports, including in those terms the services and obligations which are called "invisible" imports and exports, will find its stock of gold disappearing, or will have to protect that gold by borrowing from its creditors.

Now let us examine the circumstances which led up to the crisis of September, 1931, in this country. We have already, in the last chapter, shown how the gold standard had been failing to work in the manner the world had grown accustomed to before the War, and that this failure had shown itself in the accumulation of the greater part of the world's stock of gold in two

countries, the United States and France. For this reason and because of the high tariff walls built by most nations for the express purpose of shutting out foreign goods, many countries found the greatest difficulty in paying the international balances due in payment of goods and interest. This difficulty was greatly enhanced by the rapid fall in prices which began to show itself in 1928. This fall in prices started as a reaction against the policy of bolstering up the prices of raw products which was pursued by most of the governments of those countries which relied on the export of primary products. The producers in these countries were subsidised by their governments in various ways in an effort to arrest the fall from the high prices of the post-war years. This caused over-production of these articles by removing the restrictions on output which lower prices would have brought about. When these measures were seen to be failing and stocks to be accumulating, prices collapsed. The trouble spread to the industrial countries whose markets were largely found among the primary producers. The fall in prices was accelerated by the collapse of the mad stock exchange boom in the United States, which brought about enormous falls in the values of securities and destroyed confidence in the industrial future owing to the decline in the effective demand for commodities.

The stage was now set for serious trouble, and the first country to show signs of collapse was Australia. The Australian states had borrowed heavily since the War and for purposes which were not always wise. The interest on these loans could only be paid by the export of the raw materials which the country

produced, and the severe drop in the prices fetched by these exports taxed to the utmost her capacity to meet these payments as they fell due. For a time there was talk in political circles of default, but by a national effort the crisis was met and passed. Similar difficulties were met in South America and elsewhere. Then the trouble extended to Europe. In May, 1931, the Credit-Anstalt, the largest bank in Austria, was in difficulties and had to seek help abroad. Next month came Germany's turn. The trouble had for some time been expected. When that country allowed the mark to crash in 1923 and her currency to become worthless, she lost her liquid capital and was only able to carry on her industrial life by the aid of money borrowed abroad, chiefly from the United States. For years the world had doubted her ability to pay at the same time the interest on this borrowed capital and the tremendous burden of reparation payment, and had speculated on the extent to which these payments were in fact being paid out of the borrowed capital. With the sudden drop in prices it was apparent that the difficulty would become acute, for her debts were payable in gold and the price of this gold in goods was proportionately increased. The more nervous of her creditors began to withdraw their money, so far as they were able, and the Reichsbank found its gold disappearing. The President of the United States, who were the principal commercial creditors, proposed a moratorium for reparation payments, but the proposal was too late, and in July, in spite of assistance granted by the Bank for International Settlements, the "Danatbank"—*i.e.*, the Darmstädter und Nationalbank—failed and was followed

by what amounted to a moratorium in payments to foreign creditors. This was embodied in a "Standstill" Agreement with Germany's foreign banking creditors, who agreed to maintain their deposits and advances to German banks for a period of six months at their existing amount.

Let us now turn to the position of our own country. For some years the financial position in Great Britain had given rise to misgivings, both at home and abroad —more particularly the latter. These misgivings were created both by the trading position of the country and by the state of the national finances. As regards the former, the balance of payments, which had regularly provided over a long series of years a substantial surplus for investment abroad, had steadily declined and, for the current year, promised a deficit. Great Britain's competitive power in international trade had declined owing to excessive costs of production. Side by side with this deterioration in the industrial position there had been a progressive extravagance in national finance. Expenditure on social services and other non-productive objects had grown to alarming proportions, particularly expenditure on unemployment insurance. Attention was drawn to the dangerous weakening of the whole structure of national finance both by the Chancellor of the Exchequer, Mr. Snowden, and by Sir Richard Hopkins, the Controller of Finance at the Treasury, but the Government took no action.

By this time the nerves of the Continental holders of sterling balances and sterling investments were thoroughly on edge, and gold began to leave the country. Credits with the United States and France

of £25,000,000 each were arranged but quickly exhausted. A National Government was formed and an emergency budget introduced with the object of putting the national finances in order and so restoring confidence abroad. But again the steps taken were too late to attain the desired object. In spite of a fresh credit raised by the Government, the drain of gold continued. Not only were sterling balances withdrawn from the London banks, but sterling bills were thrown on the market and the Continental holders of British Government securities, alarmed by the conversion to a lower rate of interest which had just been forced on the domestic holders of Australian Government securities and the fear of similar steps in this country engendered by rash talk in English political circles, threw their holdings on the London market.

On September 20th the Government announced their intention of suspending gold payments by the Bank of England. It will be seen that the country was forced into this step by two sets of causes. On the one hand the foreign situation was peculiarly threatening. London was the world's banker and the world was in the mood which produces a run on its banks—a general breakdown in confidence and a general need for ready cash. On the other hand, London was especially vulnerable to a foreign drain. Her short term commitments had been steadily growing. Her high production costs and her relatively high price level had produced an unfavourable balance of payments and unfavourable exchange rates which a high bank rate could not hope to counterbalance for long. It was for this last reason that the Bank

of England did not resort to the usual expedient of a high bank rate before abandoning gold payments. Such an expedient, valuable as it is to meet a temporary emergency, is useless in circumstances which the country then had to face.

The result of the step taken on September 20th was naturally an accentuation of the general lack of confidence. Sterling had been regarded by a large part of the world as almost synonymous with gold, and the drop in its gold value caused much loss and hardship among this country's creditors. London suffered a loss in prestige which it may take a long time to overcome, and to look at this unavoidable step as a clever dodge—an attitude taken by a section of the Press—was deplorable. It was not a deliberate step, but was forced upon the country partly by the force of external circumstances and partly by her own mistakes. Its immediate effects were to give a temporary stimulus to her exporting industries, because, while sterling costs for a time remained constant, the fall in exchange rates lowered the cost of British products to the foreigner. This tendency, however, was offset to some extent because some of our foreign competitors followed suit in abandoning gold, while others imposed countervailing duties. In time, too, manufacturing costs might be expected to rise, for imports into this country would rise in price by reason of the lower purchasing power of sterling abroad, and the proportion of raw materials which can be produced at home is small.

The real hope for the future lies in the fact that the world now sees plainly that the post-war working of

the gold standard cannot be continued and that some alternative must be provided. That alternative must be international if it is to be effective. No country can permanently cut its currency off from that of its fellows any more than it can isolate its industries and trade. At the root of the trouble from which the world is suffering is the exaggerated nationalism which has prevailed since the War—and before. The obstacles to the free interchange of commodities, both legal and psychological, must be broken down.

It has been suggested that a group of nations should be formed whose currencies shall be based on sterling. Such a step, if possible, would be better than nothing; it would be a step in the right direction, but, of itself, it would be insufficient. The British Empire and those nations which cared to accommodate their trading relations to the group could not afford to leave out the rest of the world for long. Taking a short view, it seems doubtful whether there is any practicable alternative to some form of the gold standard, but before that can be re-established there must be some settlement of the international debt problem, and some compromise on the subject of tariffs.

CHAPTER XXVIII.

CURRENCY DEVALUATION.

THE question is sometimes asked whether Great Britain could have remained on the gold standard in September, 1931, by any effort of her own, or whether the country ran away from the difficulties which faced it. Certainly there was a belief both in America and on the Continent of Europe that the step was dictated by a desire to obtain a trading advantage over this country's competitors. If the price of sterling in dollars or francs or marks were allowed to fall, the holders of these foreign currencies could purchase British goods more cheaply, and the recognition of this fact was widely regarded as the compelling motive behind the action of the British Government. Even though the difficulties occasioned by the drain of gold from London were admitted, it was pointed out that the Bank of England had not taken the time-honoured precaution of raising its Bank Rate with the object of counteracting the drain.

The truth is that, although such a remedy was effective when the gold standard was functioning smoothly and the drain of gold was due to temporary causes, it was quite powerless to stem a drain resulting

from an adverse trade balance spreading over a period of years. The balance of trade was against us because the prices of goods produced in this country were too high. It was cheaper to buy abroad and the foreigner would not pay our prices. Exports were discouraged and imports encouraged by this disparity between our prices and those of our neighbours. Put in another way, the pound sterling was over-valued in terms of the currency of other countries. The remedy was therefore either to cheapen the costs of production or cheapen the price of the pound sterling to the foreign purchasers of our manufactures.

On paper it would appear a matter of no great difficulty to reduce costs if the assumption were granted that a drop in prices would follow. In practice the attempts to do so during the post-war years met with strenuous resistance and produced a series of disastrous industrial strikes. It is useless to point out in such circumstances that one of the alternatives of a reduction in costs or a depreciation of the currency must be adopted, and that in the long run the latter is the more damaging to the national economy. The man whose wages or salary is cut, even though the level of his earnings is admittedly higher than that of his neighbours in similar circumstances, feels keenly that the attack on his standard of living is a personal attack and is able to observe that others escape scot free. It is easier and much more popular to adopt the alternative remedy and depreciate the currency, or take such steps as are sure to lead to a depreciation of the currency. Their effect is not at first recognized, and the public is persuaded that the consequent rise in the cost of living will not occur.

Great Britain's abandonment of the gold standard in 1931 was of course not in itself a depreciation of her currency. She did not by legislation reduce the gold content of the sovereign, as other countries have done before and since, nor did she increase the limit of the Bank of England's fiduciary issue and so enlarge the basis of the Bank's power to increase the volume of banking credit. But it was nevertheless recognized that the gold value of the pound would fall. The attempt to keep it up to an artificial level was abandoned with the full knowledge that the fall would occur. The extent of the fall is shown in the following table of the value of the pound as a percentage of its gold value in 1929, taken from the Monthly Bulletin of Statistics of the League of Nations for October, 1936, p. 480 :—

1929	100	1934	62·3
1931	93·2	1935	59·8
1932	72·0	Sept. 1936	61·1
1933	68·1		

Those who have followed carefully the explanations of monetary principles set out in this book will understand that one of the first results to be expected from this fall in the gold value of sterling would be a rise in the sterling prices of commodities. That it did not occur has helped to obscure the issue and to blind many people to the real nature of the step taken in 1931. Here are two tables showing the variations in the index number of commodities, the first of which is taken from the Monthly Review of Lloyds Bank Ltd., for November, 1936, and has for a percentage basis the wholesale prices ruling on September 16th, 1931, after the commencement of the depression but before going off gold. The second table is taken from the League

of Nations Bulletin for October, 1936, and the basis is the year 1929, before prices had commenced to fall owing to the depression.

WHOLESALE PRICES, UNITED KINGDOM.

I		II	
Sept. 16th,	1931 = 100	Average	1929 = 100
Average	1931 = 107·7	"	1931 = 76·8
"	1932 = 103·5	"	1932 = 74·9
"	1933 = 103·5	"	1933 = 75·0
"	1934 = 106·4	"	1934 = 77·1
"	1935 = 108·1	"	1935 = 77·9
Oct.	1936 = 120·8	Sept.	1936 = 83·4

From these tables it will be seen that the wholesale sterling prices of commodities, most of which were imported into this country from abroad, showed no appreciable rise in the years succeeding our departure from the gold standard. Although the pound would purchase substantially less of the currency of the gold-using countries, it maintained its purchasing power over commodities. The explanation of this curious paradox is to be found in the intensity of the trade depression which followed the 1931 crisis and which induced the principal commercial nations to go to extreme lengths in protecting their own markets by every device known to them: tariffs, quotas and direct prohibition. Oblivious of the fact that the country which exports its own produce can in the long run receive payment only in goods or services, every country was engaged in the hopeless task of encouraging its own exports while at the same time prohibiting or strictly limiting its imports. This country, in spite of its break with its traditional free trade policy, still offered one of the largest markets to the world's output

of food and raw materials, and producers all over the world were forced to make the best of the situation and accept such prices as resulted from the competition to find purchasers for accumulating stocks. A further factor which hindered the fall in the purchasing power of sterling is to be found in the fact that a number of countries, more particularly those which looked to Great Britain for a market for their produce, linked their currencies to sterling in 1931, so that in these countries the purchasing power of sterling remained for the time unaffected. These compensating factors cannot, however, be permanent, and it can hardly be expected that the world will continue to supply us with the raw materials of our industries at the prices which have ruled during the past five years. Indeed, the visible stocks of such products as wheat, wool and rubber have steadily declined and their prices sharply risen.

The example set by Great Britain and followed almost at once by the British Dominions and the group of Scandinavian nations found other imitators within a few years, including Japan, the United States and Belgium. Others, such as Germany and France, were prevented from following only by the remembrance, particularly in Germany's case, of the previous post-war devaluation and the painful experience resulting from it. Only by rigid restrictions on freedom of trade and financial dealings was the necessity avoided or delayed.

For those who wish to study the recent history of currency fluctuations, the table given on p. 453 of the Monthly Bulletin of Statistics published by the League of Nations for October, 1936, will be found interesting. It shows that of the fifty-four nations enumerated only

five have maintained their currencies at a gold parity equal to that existing in 1929. The French Government, right up to a few days before the change, reiterated its determination to avoid devaluation, but in September, 1936, it gave way and legislation was passed allowing for a depreciation of from 25·19 to 34·35 per cent. in the previous gold value of the franc.

At the same time the governments of Great Britain, France and the United States announced an international monetary understanding in which the first-named reaffirmed their purpose to continue the policy which they had pursued in recent years, the object of which was to maintain the greatest possible equilibrium in the system of international exchanges and to avoid to the utmost extent the creation of any disturbance of that system by British monetary action. The other governments made similar declarations and invited the co-operation of other nations.

This declaration is indicative of the anxiety felt by the parties to it over the currency developments of the past five years and the possibility that currency devaluation would become an instrument of policy in the hands of the nations and a weapon to be used in the struggle for commercial advantage over each other. Currency devaluation is a stimulant which may have pleasing results in times of depression, but like other stimulants its effects are temporary, its after-effects unpleasant and, if persisted in, may lead to disaster. It is profitable to the government because the value of their stock of gold is enhanced and the burden of their debt diminished. It is profitable to exporters because, as we have seen, it enables them to quote a higher price to the foreigner. It is true that imports

cost more, but as devaluation is usually undertaken in times of commercial distress when prices are falling, this effect is often delayed.

The advantages gained by one section of the community are, however, gained at the expense of other sections. The devaluation is a capital tax on such property as exists in the form of a money debt, though not on all property. Those with fixed incomes suffer from the loss of the purchasing power of those incomes. It is the habit to speak slightingly of such persons as rentiers and to assume that any disadvantage suffered by them is, from a national point of view, offset by the advantage conferred on the debtor class, which is usually the producing and employing class. But the persons with fixed incomes include far more than the "idle rich." Among them are those who have endeavoured to provide for their old age by means of subscriptions to pension funds, premiums to endowment policies and other methods of saving, and whose efforts are frustrated by the fall in the purchasing power of their incomes. Besides these there is a numerous body of men whose remuneration for the services they render is fixed by custom or law and cannot easily be increased. As a deliberate policy currency valuation must be condemned as an expedient productive of much injustice between man and man and between class and class. It is defensible only in time of national emergency such as that created by war, or, with less certainty, as a means of restoring world trade which has been choked by artificial barriers such as those which exist at the present time.

One of the consequences of the fear of further devaluation which has haunted the world for the past few

years has been the spectacle of the rush to transfer the ownership of liquid capital from one country to another and back again, whenever danger threatened, in a frenzied attempt to escape loss or to make speculative profit. The result is seen in violent fluctuations in exchange rates which present serious obstacles to those carrying on legitimate commercial or financial transactions. To prevent or modify these fluctuations the British Government introduced a provision in the Finance Act of June, 1932, establishing what is officially known as the Exchange Equalisation Account, but more commonly called the Exchange Equalisation Fund. The amount of the Fund was £150,000,000, increased in the following year to £350,000,000. Treasury Bills not exceeding this sum are placed at the disposal of the Bank of England, acting as the agents of H.M. Treasury, and with the proceeds of these Bills, the Bank is authorized to buy and sell sterling, foreign currencies or gold with the object of counteracting exchange movements due to speculative or other temporary causes and so flattening out the curve of exchange rate movements. The Fund is not intended, and indeed is too small, to be used to affect permanently the rates of exchange with this country, and it is an essential part of the scheme that no information whatever is given to the public with regard to the operations on the Account. Only by keeping the speculator in ignorance of the position existing at the time of his operations can he be effectively checked. Similar Funds have recently been started in other countries.

CHAPTER XXIX

BIBLIOGRAPHY.

THIS chapter does not pretend to be an exhaustive record of banking and financial authorities. It is intended only to guide the student in the selection of those works which will be useful to him, if he wishes to pursue further the topics which have been treated in the course of the preceding chapters. No doubt many other works which are well worthy of perusal will occur to the mind of the reader, but in the interests of simplicity, and to avoid overwhelming the student with too formidable a mass of literature, it has been thought advisable to omit any mention of more than one or two works which cover the same ground.

On the general principles of money the student will find two good introductory text-books in the small volumes by E. Cannan and D. H. Robertson, each with the same title, "Money." Students requiring an explanation of the principles which should govern the regulation of a paper currency should read Gustav Cassel's "Money and Foreign Exchange after 1914," which contains a searching criticism of the errors committed during and after the war.

Perhaps the best general text-book on banking, especially for those engaged in a bank and therefore familiar with the more technical aspect of the subject, is H. P. Sheldon's "The Practice and Law of Banking." Rae's "Country Banker," though written nearly forty-five years ago, when the business of banking was carried on in very different circumstances from those which now exist, possesses astonishing vitality and there is no better book on the human aspect of the subject. "English Banking Methods," by Dr. L. le M. Minty, is a reliable text-book on the internal management of a bank. The Journal of the Institute of Bankers contains a mine of information upon all subjects connected with banking and money, written by the best authorities of the day, and the volume of "Questions on Banking Practice" contains the opinion of the Council of the Institute on almost every subject of practical interest which can arise. The subject of banking advances against security is well covered by F. R. Stead's "Bankers' Advances" and "Bankers' Tests," L. A. Fogg's "Bankers' Securities against Advances," and F. J. Lewcock's "The Securities Clerk in a Branch Bank."

Turning from these general works on banking and currency to the more specialised subjects, we are met by the difficulty of finding a single adequate account of the first of these subjects, the bimetallic controversy. Giffen's "Case against Bimetallism" and Macleod's "Bimetalism" are two of the leading expositions of the monometallic case, and Walker's "International Bimetallism" and the "Colloquy on Currency" by H. H. Gibbs (afterwards Lord Aldenham) are two of the best accounts of the reverse side.

Those, however, who wish a thorough knowledge of the subject are recommended to study the Reports and Evidence of the Royal Commission appointed to inquire into the Changes in the Relative Values of the Precious Metals, commonly called the Gold and Silver Commission, which sat in 1887–1888.

Turning to the Bank of England, the best historical and critical accounts of the Bank are both written by foreigners, the "History of the Bank of England" by A. Andréadès, a Greek professor, and the "History of the Bank of England" by E. Philippovich, a German. There are excellent translations of both. Turning to the general subject of central banking, students should consult "Central Banks," by Kisch and Elkin, which contains a synopsis of the charters of the government and semi-government banks throughout the world.

The Bank Act of 1844 is discussed by all the writers on banking theory mentioned above, while the Reports of the Select Committees on the Bank Act in 1857 and 1858 are useful reading.

On the subject of the Money Market we have "The Discount Market in London," by H. W. Greengrass. This should be supplemented by Hartley Withers's interesting and stimulating volume, "The Meaning of Money," while there is a small book, called "How to read the Money Article," by C. Duguid, which will be found convenient for reference.

A detailed description of the London Clearing House and its methods will be found in "The Bankers' Clearing House," by P. W. Matthews, a former Chief Inspector of the Clearing House. Those wishing to study the Foreign Exchanges will find the

theory of the subject explained in Professor Cassel's book referred to above, "Money and Foreign Exchange after 1914." For a more intimate acquaintance with the details of the business he may consult "A Manual of Foreign Exchange," by H. E. Evitt.

As regards banking law, Paget's "Law of Banking" will be found most useful for banking men. Sir John Paget's long association with the Institute of Bankers has enabled him to appreciate better than most lawyers the attitude of bankers towards the law, an attitude which, it is needless to say, is quite different from that of the lawyer. Besides this work, Hart's "Law of Banking" is likely to find favour, being sound and comprehensive.

The law of bills of exchange is best studied from the Act of 1882, which has been annotated by Sir Mackenzie Chalmers, the draftsman of the Act. His larger "Digest of the Law of Bills of Exchange" is a standard work which is invaluable to the practical banker.

Those wishing further information concerning the constitution and powers of joint stock banks and other companies registered under the Companies Act should consult a standard work such as Buckley on Companies, or Lindley on Companies. If a smaller work be desired, nothing is better than Gore-Browne and Jordan's "Handy-book of Joint Stock Companies."

For an authoritative guide to recent developments in monetary practice and policy throughout the world the student may well consult the periodical publications of the Economic Intelligence Service of the League of Nations.

TEST QUESTIONS.

The following questions are intended to assist the student in testing the extent of his knowledge of the subjects treated in the preceding chapters. They are taken, by kind permission, from papers set by the undermentioned examining bodies. The initials at the end of each question denote the source from which the question is quoted:

I.B.	=	Institute of Bankers.
I.B.S.	=	Institute of Bankers in Scotland.
I.B.I.	=	Institute of Bankers in Ireland.
L.C.C.	=	London Chamber of Commerce.

CHAPTERS I. AND II.

1. What do you understand by a measure of value? Describe its attributes; illustrate by considering the respective fitness of wheat, labour, and gold to act as such measure. [I.B.

2. What are the grounds upon which it has been held that a rise in the value of money is an evil? Examine them; explaining how you would measure such a rise. [I.B.

3. On what grounds is stability in the value of money held to be desirable? What is the precise meaning and proper test of such stability? [I.B.

4. Distinguish clearly between Value and Price, and show that the distinction is sometimes important. Consider especially the case of gold. [I.B.S.

5. Why is it said to be "evident that, though there cannot be a general rise or fall in values, there can be a general rise or fall in prices"? [I.B.I.

CHAPTER III.

1. Explain Gresham's Law, and give examples of its application. What are the conditions essential to its operation? [I.B.S.

2. Explain Gresham's Law about coins. Does it apply to paper money? [I.B.I.

3. Explain and illustrate Gresham's Law. State its cause and the mode of its operation. [I.B.

CHAPTER IV.

1. What is the meaning of legal tender—limited and unlimited? [I.C.

2. If a person had gold to sell, which course would you recommend, to sell it to the Bank of England or to send it to the Mint to be coined? Give your reasons. [I.B.I.

3. Distinguish between the simple, multiple, and composite legal tender systems. [L.C.C.

CHAPTER V.

1. What was the relation of gold to silver as legal tender in England from 1717 till the adoption of the gold standard in 1816? [L.C.C.

2. What were the causes that led to the adoption of the gold standard in England? [L.C.C.

3. "It is a very general belief that the limitation of the legal tender of silver to 40*s*. is the cause of our half-crowns circulating at their token value in gold."

Explain the terms *token* and *legal tender*. Do you consider this general belief well founded? [I.B.

CHAPTERS VI. AND VII.

1. Indicate briefly the advantages and disadvantages of gold as the standard of value. How would a return to bimetallism on the part of the United Kingdom be likely to affect the prices of commodities therein? [L.C.C.

2. How did the gold discoveries of 1848 to 1850 act on the standard of value in France? [L.C.C.

3. How is the value of gold determined? Mention the principal alterations in its value since 1848, with their causes. [I.B.

4. Explain the leading causes of the great fall in the gold price of silver since 1873. [I.B.S.

5. When and by what countries was the Latin Union first founded? State briefly the arguments used for and against bimetallism. [L.C.C.

6. Sketch briefly the causes that led to the demonetisation of silver by Germany in 1871, and by the United States in 1873. [L.C.C.

7. How do you account for the recent decline of public interest in bimetallism as a practical system of currency? [L.C.C.

CHAPTERS VIII. AND IX.

1. Criticise the following:—If credit is the principal circulating medium, and so far as prices depend upon the circulating medium, it is to credit and not to gold that we must look as the immediate regulator of prices. [L.C.C.

2. What is inconvertible paper money? In what circumstances is it employed? How far does it satisfy the requirements of good money, and what are its defects? [I.B.

3. How could you (a) measure, (b) regulate, the value of an inconvertible currency? What are the objections to a currency of this kind? [I.B.

4. What is Credit? Show how an expansion of Credit may affect *General* Prices, and indicate the real *limits* to Credit inflation. [I.B.S.

5. During what years did the Bank Restriction Act of 1797 remain in force—what was its effects on the currency? [L.C.C.

CHAPTER X.

1. Describe the circumstances that led to the passing of the Bank Act of 1844, and state its principal objects. [I.B.

2. According to Lord Overstone, "the one simple duty which the manager of the currency has to perform is that of making the amount of paper circulation vary precisely as the amount of the circulation would have varied had it been exclusively metallic."

Examine this doctrine as applied to the cases (a) of a national, (b) of a local note issue. [I.B.

3. Show the importance in the Credit System of the United Kingdom of an adequate Banking Reserve in the Bank of England. [I.B.S.

4. A customer of a branch bank asks for a draft of the branch upon its head office for £50 2*s.* 6*d.*, and requests the branch to make it payable to "bearer." Are there any objections to issuing such a draft, and, if so, what are they? [I.B.

CHAPTER XI.

1. Explain the principal provisions of the Bank Act, of 7 Geo. 4, c. 46 (1826). [L.C.C.

2. When and how was the Bank of England deprived of the monopoly of Joint Stock Banking in London? [L.C.C.

3. Enumerate the different classes of banks in England and Wales, stating briefly the differences in their constitution. [I.B.

4. A bank is registered under the Act of 1879 with a subscribed capital of £1,000,000, divided into shares of £40 each, on which £10 have been paid up: what is the nature of the "reserve liability" formed of the remaining £30 per share? [I.B.I.

5. There is a movement towards the absorption of the private banks in England by the larger joint-stock establishments. What is likely to be the ultimate effect of this amalgamation movement (a) as regards English banking, and (b) as regards the general public? [I.B.S.

CHAPTER XII.

1. Describe the manner of clearing country bank cheques through the London Bankers' Clearing House. [L.C.C.

2. Describe the Clearing House and its economic services. What inferences may be deduced from a study of the Clearing House accounts? [I.B.

3. Describe the country clearing and trace the course of a cheque payable in Leeds, and received by a banker in Bristol. [I.B.

4. Enumerate and distinguish between the three divisions of the London Bankers' Clearing House. [L.C.C.

CHAPTER XIII.

1. What do you consider the "liquid resources" of a bank? [I.B.

2. In the event of a run on a Bank, what resources would such a Bank fall back on first? [I.B.S.

3. State generally the sources of a bankers' profits, the chief items in his expenditure, and the probable causes of his losses. [I.B.

4. Describe the different methods in which a banker employs his resources, and state roughly the average proportion of each holding that is usually maintained by the London banks. [I.B.

5. In discounting bills for a customer, what are the points to be considered? [I.B.

CHAPTER XIV.

1. State briefly the relations between a banker and his customer, and those between a banker and the public. [I.B.

2. John Jones has a banking account in his own name, and pays into his credit cheques payable to the order of Smith, Brown & Co., for whom he is agent, which he endorses *per pro.* Under what circumstances would you receive such cheques to his credit? [I.B.

3. On most printed credit slips issued by bankers you will find a request similar to the following: "Customers are requested to cross all cheques before paying them in." What is the reason for this request? [I.B.

4. A banker cashes two cheques upon another bank for a stranger. A week after payment it is discovered that in one case the drawer's signature is a forgery, in the other case the payee's signature is a forgery. What is the position of the banker who cashed the two cheques ? [I.B.

5. State what would be the liability on a bank if valuables deposited with it for safe custody were lost or stolen. [I.B.

6. What responsibilities does a banker assume for the custody of—

(a) Share certificates left with him in a closed box.

(b) Bonds from which he has instructions to cut off the coupons and collect them for his customer's credit.

(c) Railway shares left with instructions to sell them through a broker ? [I.B.

CHAPTER XV.

1. How should cheques be endorsed which are payable to the order of the following :—

(1) Mrs. George Smith.

(2) The executors of the late John Smith.

(3) The trustees of the late John Smith.

(4) The Borough of Southtown.

(5) John Smith in full settlement of account. [I.B.

2. What is your opinion of the following endorsements on cheques ?—

(a) Payable to "the Trustees of John James," and endorsed "For Self and co-trustees of John James,"
"E. Howard."

(b) Payable to "John James or bearer," and endorsed "Pay to the order of E. Howard,"
"John James."

(c) Payable to "John James or order," and endorsed "John James," with a further endorsement below, "pay to the order of W. Smith, E. Howard."

Give reasons for your answer in each case. [I.B.

3. An unknown man presents for payment an open cheque, payable to John Smith or order, but not endorsed. He states that he is John Smith, but is unable to write. What should the cashier do ? [I.B.

CHAPTER XVI.

1. Detail specific instances when a banker must not pay his customer's cheque, giving the answers which may properly be used in each case. [I.B.

2. A and B, not partners, kept a joint account with you, all cheques requiring the signatures of both. A dies, the balance at the time being in credit. What steps should you take, and why? [I.B.

3. What is a garnishee order, and what steps should a branch manager take on receiving such an order relating to one of his customers who has a credit balance on his current account, and a deposit account repayable at seven days' notice? [I.B.

4. What should a cashier do to whom an open cheque is presented for payment in the following circumstances?—

(a) Cheque drawn by Brown, Jones & Co., notice having been received that Brown, the partner who signed the cheque in the firm's name, has committed an act of bankruptcy.

(b) Cheque drawn "per pro. John Jones, A. Smith," notice having been received that A. Smith is dead. [I.B.

CHAPTERS XVII. AND XVIII.

1. Compare the respective merits of the following forms of collateral security:

Deposit of title deeds.
Railway stock registered in the bank's name.
Securities to bearer.
Transfers in blank.
Local shares. [I.B.I.

2. What points are of primary importance when considering an application for an advance made by a limited company, and what particular form of security is in such cases desirable and available for the company? [I.B.I.

3. Share securities taken by a banker prove subsequently to be trust property; how is the banker affected? [I.B.I.

4. Give your opinion as to how far loans (a) on land and buildings, and (b) on life policies are advisable; and (c) if so under what safeguards. [I.B.S.

5. A, B, and C give a joint and several guarantee for an account of one of your customers. B wishes to withdraw from the guarantee. What steps should you take? [I.B.

CHAPTER XIX.

1. Define "Bank Rate," "Market Rate," and "Deposit Rate," and show the connection between them. [L.C.C.

2. In what way does a rise in the Bank Rate affect (a) wholesale trade; (b) the Stock Exchange; (c) banking profits? [L.C.C.

3. Does the Bank of England Rate always control the money market? Give reasons for your answer. [I.B.I.

4. What is meant by "money at call," and what is the advantage it offers to the banker? [I.B.

5. Give an account of the principal periodic fluctuations or disturbances in the money market. Particularly explain the reasons of the extra drain upon the Bank Reserve in or about the month of October in each year. [I.B.

CHAPTER XX.

1. Explain the significance of the items "Other Deposits" and "Other Securities" in the weekly return of the Bank of England. How is the variation in the amount of "Other Securities" in the Banking Department at the turn of the year and of the half-year accounted for, and what weakness in our banking system does it reveal? [L.C.C.

2. State the functions which the Bank of England discharges to the State and to the other banks. [I.B.S.

3. Quote as nearly as possible a recent return of the Bank of England, and describe the meaning of the various items. [I.B.

CHAPTERS XXI. AND XXII.

1. What are the essential conditions to ensure a movement of bullion from, say, Paris to London, or *vice versâ?* What

determines the maximum variation in the rates of the Real Exchange between any two countries? [I.B.I.

2. Explain the terms "favourable" and "unfavourable" in connection with the Foreign Exchanges, and also the saying "high rates are for us, and low rates against us." [I.B.I.

3. Explain the reasons why Britain draws few Foreign Bills but accepts many. [I.B.S.

4. State, with reasons, what effect a rise in the value of money in London has upon Foreign Exchanges. [I.B.S.

5. If the Paris Exchange falls below 25·10 or rises above 25·35, how would accounts between London and Paris very probably be paid? Give reasons for your answer? [I.B.S.

CHAPTER XXIII.

1. What is the difference between a Stock Jobber and a Stock Broker, and what are their respective duties? [I.B.S.

2. What are Inscribed Stocks; wherein do they, as a rule, differ from other British Stocks; and how are they transferred. [I.B.S.

3. Define the following terms, viz.: bull, bear, contango, and backwardation. Explain fully the method of "carrying over" Stock on the Stock Exchange. [I.B.S.

4. What is Settling-day on the Stock Exchange? How often does it occur, and what is its use? [I.B.S.

CHAPTER XXIV.

1. Explain the nature and causes of commercial crises. [I.B.S.

2. Is an over-issue of Convertible Bank Notes possible? Consider what is meant by "over-issue." [I.B.S.

3. State the important functions which the Bank of England performs during times of financial crisis, and why it is in a position to perform such functions. [I.B.S.

4. Describe the nature of credit and its action as a convenience or a disturber of price; analyse a crisis, giving primary causes, subsidiary agents, the precipitating causes and subsequent results. Illustrate from some special case. [I.B.

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